

**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, 2015**

or

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

**For the transition period from**                      **to**                      **.**

**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, 14<sup>th</sup> 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 Website, 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 April 30, 2015, there were 289,915,838 shares of common stock outstanding.

**E\*TRADE FINANCIAL CORPORATION**  
**FORM 10-Q QUARTERLY REPORT**  
**For the Quarter Ended March 31, 2015**  
**TABLE OF CONTENTS**

|                 |  |                    |
|-----------------|--|--------------------|
| <b>PART I</b>   | <b>FINANCIAL INFORMATION</b>   |                    |
| <b>Item 1.</b>  | <a href="#">Consolidated Financial Statements (Unaudited)</a>  | <a href="#">37</a> |
|                 | <a href="#">Consolidated Statement of Income</a>   | <a href="#">37</a> |
|                 | <a href="#">Consolidated Statement of Comprehensive Income</a>   | <a href="#">38</a> |
|                 | <a href="#">Consolidated Balance Sheet</a>   | <a href="#">39</a> |
|                 | <a href="#">Consolidated Statement of Shareholders' Equity</a>   | <a href="#">40</a> |
|                 | <a href="#">Consolidated Statement of Cash Flows</a>   | <a href="#">41</a> |
|                 | <a href="#">Notes to Consolidated Financial Statements (Unaudited)</a>                                       | <a href="#">43</a> |
|                 | <a href="#">Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies</a>    | <a href="#">43</a> |
|                 | <a href="#">Note 2—Operating Interest Income and Operating Interest Expense</a>                              | <a href="#">46</a> |
|                 | <a href="#">Note 3—Fair Value Disclosures</a>  | <a href="#">46</a> |
|                 | <a href="#">Note 4—Offsetting of Assets and Liabilities</a>  | <a href="#">53</a> |
|                 | <a href="#">Note 5—Available-for-Sale and Held-to-Maturity Securities</a>                                    | <a href="#">55</a> |
|                 | <a href="#">Note 6—Loans Receivable, Net</a>   | <a href="#">59</a> |
|                 | <a href="#">Note 7—Accounting for Derivative Instruments and Hedging Activities</a>                          | <a href="#">65</a> |
|                 | <a href="#">Note 8—Securities Sold Under Agreements to Repurchase and FHLB Advances and Other Borrowings</a> | <a href="#">67</a> |
|                 | <a href="#">Note 9—Corporate Debt</a>  | <a href="#">68</a> |
|                 | <a href="#">Note 10—Accumulated Other Comprehensive Loss</a>   | <a href="#">69</a> |
|                 | <a href="#">Note 11—Earnings per Share</a>   | <a href="#">70</a> |
|                 | <a href="#">Note 12—Regulatory Requirements</a>  | <a href="#">70</a> |
|                 | <a href="#">Note 13—Commitments, Contingencies and Other Regulatory Matters</a>                              | <a href="#">72</a> |
|                 | <a href="#">Note 14—Segment Information</a>  | <a href="#">75</a> |
|                 | <a href="#">Note 15—Subsequent Event</a>   | <a href="#">77</a> |
| <b>Item 2.</b>  | <a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>        | <a href="#">1</a>  |
|                 | <a href="#">Overview</a>   | <a href="#">1</a>  |
|                 | <a href="#">Earnings Overview</a>  | <a href="#">5</a>  |
|                 | <a href="#">Segment Results Review</a>   | <a href="#">11</a> |
|                 | <a href="#">Balance Sheet Overview</a>   | <a href="#">14</a> |
|                 | <a href="#">Liquidity and Capital Resources</a>  | <a href="#">18</a> |
|                 | <a href="#">Risk Management</a>  | <a href="#">23</a> |
|                 | <a href="#">Concentrations of Credit Risk</a>  | <a href="#">25</a> |
|                 | <a href="#">Summary of Critical Accounting Policies and Estimates</a>  | <a href="#">31</a> |
|                 | <a href="#">Glossary of Terms</a>  | <a href="#">31</a> |
| <b>Item 3.</b>  | <a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>                                   | <a href="#">34</a> |
| <b>Item 4.</b>  | <a href="#">Controls and Procedures</a>  | <a href="#">77</a> |
| <b>PART II</b>  | <b>OTHER INFORMATION</b>   |                    |
| <b>Item 1.</b>  | <a href="#">Legal Proceedings</a>  | <a href="#">77</a> |
| <b>Item 1A.</b> | <a href="#">Risk Factors</a>   | <a href="#">77</a> |
| <b>Item 2.</b>  | <a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a>                                  | <a href="#">77</a> |
| <b>Item 3.</b>  | <a href="#">Defaults Upon Senior Securities</a>  | <a href="#">77</a> |
| <b>Item 4.</b>  | <a href="#">Mine Safety Disclosures</a>  | <a href="#">77</a> |
| <b>Item 5.</b>  | <a href="#">Other Information</a>  | <a href="#">77</a> |
| <b>Item 6.</b>  | <a href="#">Exhibits</a>   | <a href="#">78</a> |
|                 | <a href="#">Signatures</a>   | <a href="#">79</a> |

*Unless otherwise indicated, references to "the Company," "we," "us," "our" and "E\*TRADE" mean E\*TRADE Financial Corporation and its subsidiaries.*

[Table of Contents](#)

E\*TRADE, E\*TRADE Financial, E\*TRADE Bank, Equity Edge, OptionsLink and the Converging Arrows logo are registered trademarks of E\*TRADE Financial Corporation in the United States and in other countries.

## PART I

### FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. These statements relate to our future plans, objectives, expectations and intentions based on certain assumptions and include any statement that is not historical in nature. These statements may be identified by the use of words such as "assume," "expect," "believe," "may," "will," "should," "anticipate," "intend," "plan," "estimate," "continue" and similar expressions. We caution that actual results could differ materially from those discussed in these forward-looking statements. Important factors that could contribute to our actual results differing materially from any forward-looking statements include, but are not limited to, those discussed under Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q; and Part I. Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC, which are incorporated herein by reference. By their nature forward-looking statements are not guarantees of future performance or results and are subject to risks, uncertainties and assumptions that are difficult to predict or quantify. Actual future results may vary materially from expectations expressed or implied in this report or any of our prior communications. The forward-looking statements contained in this report reflect our expectations only as of the date of this report. You should not place undue reliance on forward-looking statements, as we do not undertake to update or revise forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made, except as required by law.

### 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, 2014.*

### 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 business strategy is centered on two core objectives: accelerating the growth of our core brokerage business to improve market share, and strengthening our overall financial and franchise position.

#### *Accelerate Growth of Core Brokerage Business*

- *Capitalize on secular growth within the direct brokerage industry.*  
The direct brokerage industry is growing at a faster rate than the traditional brokerage industry. We are focused on capitalizing on this growth through ensuring our customers' trading and investing needs are met through our direct relationships.
- *Enhance digital and offline customer experience.*  
We are focused on maintaining our competitive position in trading, margin lending and cash management, while expanding our customer share of wallet in retirement, investing and savings. Through these offerings, we aim to continue acquiring new customers while also deepening the engagement of both new and existing customers.
- *Capitalize on value of corporate services business.*  
Our corporate services business is a strategically important driver of brokerage account growth for us. We are leveraging our industry-leading position to improve client acquisition, and are bolstering awareness among plan participants of our full suite of offerings.
- *Maximize value of customer deposits while improving balance sheet efficiency.*  
Our brokerage business generates a significant amount of stable, low-cost deposits, which we monetize through the bank by investing primarily in low-risk, agency mortgage-backed securities.

## [Table of Contents](#)

### *Strengthen Overall Financial and Franchise Position*

- *Manage down legacy investments and mitigate credit losses.*  
We continue to manage down the size and risks associated with our legacy loan portfolio, while mitigating credit losses where possible.
- *Continue to execute on our capital plan.*  
Our capital plan was laid out in 2012 with a key goal of distributing capital from E\*TRADE Bank to the parent company, with the key objective of reducing corporate debt. We are now focused on utilizing excess capital created through earnings and by achieving lower capital requirements at E\*TRADE Bank, while continuing to demonstrate sustainability of our enterprise risk management culture and capabilities.

### **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;
- the level and volatility of interest rates;
- our ability to move capital to our parent company from our subsidiaries subject to various regulatory approvals; 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 our retirement, investing and savings customer products;
- continue to demonstrate the sustainability of our enterprise risk management culture and capabilities;
- mitigate credit costs;
- manage to a lower Tier 1 leverage ratio at E\*TRADE Bank, as stated in our capital plan;
- generate capital sufficient to meet our operating needs at both E\*TRADE Bank and our parent company;
- evaluate and utilize excess capital to maximize shareholder value;
- assess and manage interest rate risk;
- maintain disciplined expense control and improved operational efficiency; and
- compete in a technology-intensive industry characterized by rapid innovation.

[Table of Contents](#)

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<br>Three Months Ended<br>March 31, |           | Variance      |
|--|---|-----------|---------------|
|  | 2015  | 2014      | 2015 vs. 2014 |
| <b>Customer Activity Metrics:</b>                                |   |           |               |
| Daily average revenue trades ("DARTs")                           | 169,951   | 197,944   | (14)%         |
| Average commission per trade                                     | \$ 10.94  | \$ 10.64  | 3 %           |
| Margin receivables (dollars in billions)                         | \$ 8.2  | \$ 7.3    | 12 %          |
| End of period brokerage accounts                                 | 3,182,639   | 3,069,961 | 4 %           |
| Net new brokerage accounts                                       | 38,716  | 71,902    | (46)%         |
| Annualized brokerage account attrition rate                      | 8.8%  | 7.1%      | *             |
| Customer assets (dollars in billions)                            | \$ 299.4  | \$ 269.0  | 11 %          |
| Net new brokerage assets (dollars in billions)                   | \$ 3.5  | \$ 4.1    | (15)%         |
| Brokerage related cash (dollars in billions)                     | \$ 41.6   | \$ 40.1   | 4 %           |
| <b>Company Financial Metrics:</b>                                |   |           |               |
| Corporate cash (dollars in millions)                             | \$ 258  | \$ 525    | (51)%         |
| E*TRADE Financial Tier 1 leverage ratio <sup>(1)</sup>           | 8.4%  | 7.0%      | 1.4 %         |
| E*TRADE Bank Tier 1 leverage ratio <sup>(1)</sup>                | 9.8%  | 9.7%      | 0.1 %         |
| Special mention loan delinquencies (dollars in millions)         | \$ 191  | \$ 195    | (2)%          |
| Allowance for loan losses (dollars in millions)                  | \$ 402  | \$ 403    | *             |
| Enterprise net interest spread                                   | 2.62%   | 2.47%     | 0.15 %        |
| Enterprise interest-earning assets (average dollars in billions) | \$ 41.1   | \$ 42.1   | (2)%          |

\* Percentage not meaningful.

(1) Beginning in the first quarter of 2015, E\*TRADE Financial and E\*TRADE Bank calculate regulatory capital under the Basel III framework using the Standardized Approach, subject to transition provisions. Prior to the first quarter of 2015, the risk-based capital guidelines that applied to E\*TRADE Bank were based upon the 1988 capital accords of the Basel Committee on Banking Supervision ("BCBS"), a committee of central banks and bank supervisors, as implemented by the U.S. Federal banking agencies, including the OCC, commonly known as Basel I. As a savings and loan holding company, E\*TRADE Financial was not previously subject to specific statutory capital requirements. Therefore, E\*TRADE Financial's Tier 1 leverage ratio as of March 31, 2014 was a non-GAAP measure and was calculated based on the Federal Reserve's well-capitalized requirements then applicable to bank holding companies. See Liquidity and Capital Resources for a reconciliation of this non-GAAP measure to the comparable GAAP measure.

*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 and 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 new and existing brokerage customers.

## [Table of Contents](#)

- 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 as well as fees earned on customer assets held by third parties outside the Company.

### *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. See Liquidity and Capital Resources for a reconciliation of this non-GAAP measure to the comparable GAAP measure.
- Tier 1 leverage ratio is an indication of capital adequacy for E\*TRADE Financial and E\*TRADE Bank. Tier 1 leverage ratio is Tier 1 capital divided by adjusted average total assets for leverage capital purposes. Beginning in the first quarter of 2015, E\*TRADE Financial and E\*TRADE Bank calculate regulatory capital under the Basel III framework using the Standardized Approach, subject to transition provisions. Prior to Basel III becoming effective, E\*TRADE Financial capital ratios were non-GAAP measures as the parent company was not yet held to regulatory capital requirements. See Liquidity and Capital Resources for additional information, including the calculation of regulatory capital ratios and a reconciliation of previously non-GAAP capital ratios to the comparable GAAP measures.
- 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 be charged-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.

### *Significant Events in the First Quarter of 2015*

#### *Received Regulatory Approval to Operate E\*TRADE Bank at a 9.0% Tier 1 Leverage Ratio and to Move Broker-Dealers from under E\*TRADE Bank*

- We received regulatory approval to operate E\*TRADE Bank at a 9.0% Tier 1 leverage ratio, reflecting significant progress on our capital plan.
- In addition, we recently received regulatory approval to move our broker-dealers, E\*TRADE Securities LLC ("E\*TRADE Securities") and E\*TRADE Clearing LLC ("E\*TRADE Clearing"), out from under E\*TRADE Bank. The revised organizational structure provides increased capital flexibility as it enables us to dividend excess regulatory capital at our broker-dealers to the parent. E\*TRADE Securities was moved from under E\*TRADE Bank in February 2015 and subsequently paid a dividend of \$434 million to the parent company. We plan to move E\*TRADE Clearing in the second half of 2015.

#### *\$75 Million Dividend Issued from E\*TRADE Bank to the Parent Company*

- We received approval from our regulators for a \$75 million dividend from E\*TRADE Bank to the parent company, totaling \$550 million in quarterly dividends since the third quarter of 2013 and continuing to reflect significant progress in our capital plan.

#### *Eliminated \$340 Million of Corporate Debt and increased the Credit Facility at the Parent Company by \$50 Million*

- We issued \$460 million of 4<sup>5</sup>/<sub>8</sub>% Senior Notes due 2023. We used the net proceeds together with \$432 million of existing corporate cash to redeem \$800 million of 6<sup>3</sup>/<sub>8</sub>% Senior Notes due 2019, reducing our total corporate debt by \$340 million to \$1 billion and resulting in a \$73 million loss on early extinguishment of debt. These transactions reduced our annual debt service costs from \$80 million to \$50 million and extended the maturity profile with no interest-bearing corporate debt maturing until 2022.
- We also increased our senior secured revolving credit facility by \$50 million to \$250 million, which remains undrawn, enhancing liquidity for the parent company.

## [Table of Contents](#)

### *New Sweep Deposit Platform*

- We completed the conversion of our sweep deposits to a new platform which will allow us to more efficiently manage our balance sheet size. During the first quarter of 2015, we utilized this platform to direct \$1.3 billion of customer sweep deposits to our balance sheet.

### *Enhancements to Our Trading and Investing Products and Services*

- We launched several mobile enhancements, including the addition of multi-leg options functionality and employee stock plan trading.
- We announced the new Apple Watch app that will deliver market data in an engaging and simple format to help investors and traders monitor their portfolios, watchlists and the markets.
- We unveiled the new tax center that centralizes the location of tax documents and better positions resources and education for cost basis reporting, gains and losses, and tax efficient investing.
- We also made multiple improvements to E\*TRADE Pro, our platform for active traders, including tax lot trading, pattern day trader enhancements and order entry updates, which when taken together deliver a more customized, intuitive, and hassle-free experience for our most active customers.

### *Third Party Recognition*

- Barron's rated us 4 out of 5 stars in their annual online broker survey, scoring high marks in research amenities and customer service and education.
- Stockbrokers.com gave us three first place awards in their 2015 Online Broker Review: #1 Smartphone App, #1 Client Dashboard and Best New Tool for E\*TRADE Browser Trading. In the same review, we also earned five best-in-class ratings for Offering of Investments, Investor Education, Research, Mobile Trading, and New Investors.
- Benzinga recognized us in their first-annual FinTech Awards with a Special Achievement award for our browser trading web app.

### *Effective Settlement of Uncertain Tax Positions Generates Approximately \$225 Million Income Tax Benefit*

- In May 2015, we effectively settled uncertain tax positions related to the Internal Revenue Service ("IRS") examination of its 2007, 2009 and 2010 federal tax returns. As a result, we will recognize approximately \$225 million of income tax benefit in the second quarter of 2015, the vast majority of which will increase our deferred tax assets. During the third quarter of 2009, the Company incurred a loss on the exchange of interest-bearing corporate debt for non-interest-bearing convertible debentures. The uncertain tax positions were primarily related to whether certain components of that loss were considered deductible or non-deductible for tax purposes. This income tax benefit will have a material impact on the effective tax rate for both the second quarter of 2015 and full year 2015.

## **EARNINGS OVERVIEW**

We generated net income of \$40 million, or \$0.14 per diluted share, on total net revenue of \$456 million for the three months ended March 31, 2015. Net operating interest income increased 3% to \$271 million for the three months ended March 31, 2015, compared to the same period in 2014, which was driven primarily by the size and mix of the balance sheet as well as an increase in net interest spread. Commissions, fees and service charges and other revenue decreased 6% to \$176 million for the three months ended March 31, 2015, compared to the same period in 2014, which was driven primarily by decreased commissions revenue.

Provision for loan losses increased 25% to \$5 million for the three months ended March 31, 2015, compared to the same period in 2014. Provision for loan losses for the first quarter of 2015 and 2014 reflected continued improvement in economic conditions and loan portfolio run-off. The lower provision for loan losses in the first quarter of 2014 was mainly due to the \$11 million benefit we recognized from a settlement with a third party mortgage originator. Total operating expenses increased 3% to \$300 million for the three months ended March 31, 2015, compared to the same period in 2014.

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.

[Table of Contents](#)

**Revenue**

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

|                                    | Three Months Ended March 31, |        | Variance      |       |
|------------------------------------|------------------------------|--------|---------------|-------|
|                                    | 2015                         | 2014   | 2015 vs. 2014 |       |
|                                    |                              |        | Amount        | %     |
| Net operating interest income      | \$ 271                       | \$ 263 | \$ 8          | 3 %   |
| Commissions                        | 114                          | 128    | (14)          | (11)% |
| Fees and service charges           | 52                           | 50     | 2             | 4 %   |
| Principal transactions             | —                            | 10     | (10)          | *     |
| Gains on loans and securities, net | 9                            | 15     | (6)           | (40)% |
| Other revenues                     | 10                           | 9      | 1             | 11 %  |
| Total non-interest income          | 185                          | 212    | (27)          | (13)% |
| Total net revenue                  | \$ 456                       | \$ 475 | \$ (19)       | (4)%  |

\* Percentage not meaningful.

**Net Operating Interest Income**

Net operating interest income increased 3% to \$271 million for the three months ended March 31, 2015, compared to the same period in 2014. Net operating interest income is earned primarily through investing deposits and customer payables in assets including: available-for-sale securities, held-to-maturity securities, margin receivables and real estate loans.

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 prepared on the basis required by the SEC's Industry Guide 3, "Statistical Disclosure by Bank Holding Companies" (dollars in millions):

[Table of Contents](#)

|   | Three Months Ended March 31, |                              |                    |                 |                              |                    |
|---|------------------------------|------------------------------|--------------------|-----------------|------------------------------|--------------------|
|   | 2015                         |                              |                    | 2014            |                              |                    |
|   | Average Balance              | Operating Interest Inc./Exp. | Average Yield/Cost | Average Balance | Operating Interest Inc./Exp. | Average Yield/Cost |
| <b>Enterprise interest-earning assets:</b>  |                              |                              |                    |                 |                              |                    |
| Loans(1)  | \$ 6,204                     | \$ 62                        | 4.00%              | \$ 8,397        | \$ 84                        | 3.99%              |
| Available-for-sale securities   | 12,341                       | 66                           | 2.15%              | 13,492          | 79                           | 2.33%              |
| Held-to-maturity securities   | 12,279                       | 88                           | 2.86%              | 10,551          | 77                           | 2.90%              |
| Margin receivables  | 7,888                        | 68                           | 3.49%              | 6,937           | 62                           | 3.64%              |
| Cash and equivalents  | 1,408                        | 1                            | 0.18%              | 1,148           | —                            | 0.15%              |
| Segregated cash   | 309                          | —                            | 0.08%              | 837             | —                            | 0.11%              |
| Securities borrowed and other   | 657                          | 31                           | 19.13%             | 752             | 17                           | 9.42%              |
| Total enterprise interest-earning assets  | 41,086                       | 316                          | 3.09%              | 42,114          | 319                          | 3.05%              |
| Non-operating interest-earning and non-interest earning assets(2)   | 4,998                        |                              |                    | 4,269           |                              |                    |
| Total assets  | \$ 46,084                    |                              |                    | \$ 46,383       |                              |                    |
| <b>Enterprise interest-bearing liabilities:</b>   |                              |                              |                    |                 |                              |                    |
| Deposits  | \$ 25,051                    | 2                            | 0.03%              | \$ 25,693       | 2                            | 0.03%              |
| Customer payables   | 6,388                        | 1                            | 0.08%              | 6,371           | 2                            | 0.15%              |
| Securities sold under agreements to repurchase  | 3,729                        | 26                           | 2.77%              | 4,457           | 35                           | 3.14%              |
| Federal Home Loan Bank ("FHLB") advances and other borrowings   | 1,301                        | 15                           | 4.65%              | 1,281           | 17                           | 5.28%              |
| Securities loaned and other   | 1,759                        | 1                            | 0.13%              | 1,226           | —                            | 0.05%              |
| Total enterprise interest-bearing liabilities   | 38,228                       | 45                           | 0.47%              | 39,028          | 56                           | 0.58%              |
| Non-operating interest-bearing and non-interest bearing liabilities(3)  | 2,417                        |                              |                    | 2,398           |                              |                    |
| Total liabilities   | 40,645                       |                              |                    | 41,426          |                              |                    |
| Total shareholders' equity  | 5,439                        |                              |                    | 4,957           |                              |                    |
| Total liabilities and shareholders' equity  | \$ 46,084                    |                              |                    | \$ 46,383       |                              |                    |
| <b>Excess of enterprise interest-earning assets over enterprise interest-bearing liabilities/Enterprise net interest income/Spread(4)</b> | <b>\$ 2,858</b>              | <b>\$ 271</b>                | <b>2.62%</b>       | <b>\$ 3,086</b> | <b>\$ 263</b>                | <b>2.47%</b>       |
| Enterprise net interest margin (net yield on enterprise interest-earning assets)  |                              |                              | 2.64%              |                 |                              | 2.50%              |
| Ratio of enterprise interest-earning assets to enterprise interest-bearing liabilities  |                              |                              | 107.48%            |                 |                              | 107.91%            |
| Return on average:  |                              |                              |                    |                 |                              |                    |
| Total assets  |                              |                              | 0.35%              |                 |                              | 0.83%              |
| Total shareholders' equity  |                              |                              | 2.93%              |                 |                              | 7.80%              |
| Average equity to average total assets  |                              |                              | 11.80%             |                 |                              | 10.68%             |

- (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 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) Enterprise net interest spread represents 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. The taxable equivalent adjustment to reconcile to net operating interest income was less than \$1 million for both the three months ended March 31, 2015 and 2014.

The fluctuation in enterprise interest-earning assets is driven primarily by changes in enterprise interest-bearing liabilities, specifically deposits and customer payables. Average enterprise interest-earning assets decreased 2% to \$41.1 billion for the three months ended March 31, 2015, compared to the same period in 2014. The decrease in average enterprise interest-earning assets was primarily in the average loans and available-for-sale securities categories, which was partially offset by increases in the average held-to-maturity securities and margin receivables categories, compared to the same period in 2014.

Average enterprise interest-bearing liabilities decreased 2% to \$38.2 billion for the three months ended March 31, 2015, compared to the same period in 2014. The decrease in average enterprise interest-bearing liabilities was primarily due to decreases in average securities sold under agreements to repurchase and average deposits, partially offset by increases in securities loaned and other.

## [Table of Contents](#)

At March 31, 2015, \$14.9 billion of our customers' assets were held at third party institutions, including third party banks and money market funds. Approximately 70% of these off-balance sheet assets resulted from our deleveraging efforts completed in prior periods. We estimate the impact of our deleveraging efforts on net operating interest income to be approximately 111 basis points based on the estimated current re-investment rates on these assets, less approximately 28 basis points of cost associated with holding these assets on our balance sheet, primarily FDIC insurance premiums. We maintain the ability to transfer the majority of these customer assets back on the balance sheet with appropriate notification to the third party institutions and customer consent, as appropriate.

Enterprise net interest spread increased by 15 basis points to 2.62% for the three months ended March 31, 2015, compared to the same period in 2014. Enterprise net interest spread is driven by changes in average balances and average interest rates earned or paid on those balances. During the three months ended March 31, 2015, the increase in enterprise net interest spread was driven primarily by the growth in margin receivables and increased revenue earned from our securities lending activities, along with lower wholesale borrowing costs due to both a decrease in the amount and a reduction in the cost of securities sold under agreements to repurchase. These increases were partially offset by the continued run-off of loans and lower rates earned on margin receivables. 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 11% to \$114 million for the three months ended March 31, 2015, compared to the same period in 2014. The main factors that affect commissions are DARTs, average commission per trade and the number of trading days.

DART volume decreased 14% to 169,951 for the three months ended March 31, 2015, compared to the same period in 2014. Option-related DARTs as a percentage of total DARTs represented 23% of trading volume for the three months ended March 31, 2015, compared to 21% for the same period in 2014.

Average commission per trade increased 3% to \$10.94 for the three months ended March 31, 2015, compared to the same period in 2014. Average commission per trade is impacted by customer mix and the different commission rates on various trade types (e.g. equities, options, fixed income, stock plan, exchange-traded funds, mutual funds, forex and cross border). Accordingly, favorable changes in customer mix and trade types impacted average commission per trade.

### **Fees and Service Charges**

Fees and service charges increased 4% to \$52 million for the three months ended March 31, 2015, compared to the same period in 2014. The table below shows the components of fees and service charges and the resulting variances (dollars in millions):

|   | Three Months Ended March |       | Variance      |       |
|---|--------------------------|-------|---------------|-------|
|   | 31,                      |       | 2015 vs. 2014 |       |
|   | 2015                     | 2014  | Amount        | %     |
| Order flow revenue  | \$ 23                    | \$ 25 | \$ (2)        | (8)%  |
| Mutual fund service fees                                    | 6                        | 5     | 1             | 20 %  |
| Advisor management fees                                     | 7                        | 5     | 2             | 40 %  |
| Foreign exchange revenue                                    | 4                        | 4     | —             | *     |
| Reorganization fees   | 2                        | 2     | —             | *     |
| Money market funds and sweep deposit revenue <sup>(1)</sup> | 5                        | 3     | 2             | 67 %  |
| Other fees and service charges                              | 5                        | 6     | (1)           | (17)% |
| Total fees and service charges                              | \$ 52                    | \$ 50 | \$ 2          | 4 %   |

\* Percentage not meaningful.

(1) Includes revenue earned on average customer assets held by third parties outside the Company, including money market funds and sweep deposit accounts at unaffiliated financial institutions. Fees earned on these customer assets are based on the federal funds rate or LIBOR plus a negotiated spread or other contractual arrangement with the third party institutions.

The increase in fees and services charges for the three months ended March 31, 2015, compared to the same period in 2014, was driven primarily by increased advisor management fees and an increase in money market funds and sweep deposit revenue, offset by a decrease in order flow revenue. The increase in advisor management fees was driven by assets in managed

[Table of Contents](#)

accounts within our retirement, investing and savings products, which were \$3.2 billion at March 31, 2015, compared to \$2.6 billion at March 31, 2014.

**Principal Transactions**

There was no principal transactions revenue for the three months ended March 31, 2015, compared to \$10 million for the same period in 2014. Principal transactions were derived from our market making business in which we acted as a market-maker for our brokerage customers' orders as well as orders from third party customers. On February 10, 2014, we completed the sale of the market making business to an affiliate of Susquehanna International Group, LLP ("Susquehanna") and no longer generate principal transactions revenue.

**Gains on Loans and Securities, Net**

The table below shows the components of gains on loans and securities, net and the resulting variances (dollars in millions):

|   | Three Months Ended March 31, |       | Variance      |       |
|---|------------------------------|-------|---------------|-------|
|   |                              |       | 2015 vs. 2014 |       |
|   | 2015                         | 2014  | Amount        | %     |
| Gains on available-for-sale securities, net | \$ 10                        | \$ 19 | \$ (9)        | (47)% |
| Hedge ineffectiveness                       | (1)                          | (4)   | 3             | (75)% |
| Gains on loans and securities, net          | \$ 9                         | \$ 15 | \$ (6)        | (40)% |

Gains on loans and securities, net decreased 40% to \$9 million for the three months ended March 31, 2015 compared to 2014. During the first quarter of 2014, we recognized a \$6 million gain on the sale of our remaining \$17 million in amortized cost of available-for-sale non-agency CMOs.

**Provision for Loan Losses**

Provision for loan losses increased 25% to \$5 million for the three months ended March 31, 2015, compared to the same period in 2014. Provision for loan losses for the first quarter of 2015 and 2014 reflected continued improving economic conditions and loan portfolio run-off. The lower provision for loan losses in the first quarter of 2014 was mainly due to the \$11 million benefit we recognized from a settlement with a third party mortgage originator. The timing and magnitude of the provision for loan losses is affected by many factors and we anticipate variability, particularly as home equity lines of credit begin converting to amortizing loans.

**Operating Expense**

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

|  | Three Months Ended March 31, |        | Variance      |       |
|--|------------------------------|--------|---------------|-------|
|  |                              |        | 2015 vs. 2014 |       |
|  | 2015                         | 2014   | Amount        | %     |
| Compensation and benefits                        | \$ 113                       | \$ 98  | \$ 15         | 15 %  |
| Advertising and market development               | 34                           | 34     | —             | *     |
| Clearing and servicing                           | 24                           | 28     | (4)           | (14)% |
| FDIC insurance premiums                          | 18                           | 24     | (6)           | (25)% |
| Professional services                            | 27                           | 24     | 3             | 13 %  |
| Occupancy and equipment                          | 21                           | 18     | 3             | 17 %  |
| Communications                                   | 19                           | 18     | 1             | 6 %   |
| Depreciation and amortization                    | 20                           | 21     | (1)           | (5)%  |
| Amortization of other intangibles                | 5                            | 5      | —             | *     |
| Facility restructuring and other exit activities | 4                            | 3      | 1             | 33 %  |
| Other operating expenses                         | 15                           | 17     | (2)           | (12)% |
| Total operating expense                          | \$ 300                       | \$ 290 | \$ 10         | 3 %   |

\* Percentage not meaningful.

[Table of Contents](#)

*Compensation and Benefits*

Compensation and benefits increased 15% to \$113 million for the three months ended March 31, 2015, compared to the same period in 2014. The increase resulted primarily from increased salaries expense due to increased headcount and increased incentive compensation when compared to the same period in 2014.

*Clearing and Servicing*

Clearing and servicing decreased 14% to \$24 million for the three months ended March 31, 2015, compared to the same period in 2014. The decrease resulted primarily from the sale of the market making business, lower trading volume and a decrease in loan servicing expenses, partially offset by an increase in fees paid to third parties that service our managed investment portfolio.

*FDIC Insurance Premiums*

FDIC insurance premiums decreased 25% to \$18 million for the three months ended March 31, 2015, compared to the same period in 2014. The decrease for the three months ended March 31, 2015 was due to the continued improvement and quality of our balance sheet, improving capital ratios and overall risk profile when compared to the same period in 2014.

*Professional Services*

Professional services increased 13% to \$27 million for the three months ended March 31, 2015, compared to the same period in 2014, primarily driven by professional services engagements focused on improving the customer experience and overall product offering, as well as our continued enterprise risk management build-out.

***Other Income (Expense)***

Other income (expense) was \$88 million and \$37 million of net expense for the three months ended March 31, 2015 and 2014, respectively, as shown in the following table (dollars in millions):

|   | Three Months Ended<br>March 31, |                | Variance<br>2015 vs. 2014 |       |
|---|---------------------------------|----------------|---------------------------|-------|
|   | 2015                            | 2014           | Amount                    | %     |
| Corporate interest expense                | \$ (21)                         | \$ (28)        | \$ 7                      | (25)% |
| Losses on early extinguishment of debt    | (73)                            | (12)           | (61)                      | 508 % |
| Equity in income of investments and other | 6                               | 3              | 3                         | 100 % |
| Total other income (expense)              | <u>\$ (88)</u>                  | <u>\$ (37)</u> | <u>\$ (51)</u>            | 138 % |

During the three months ended March 31, 2015, we issued \$460 million of 4<sup>5</sup>/<sub>8</sub>% Senior Notes and we used the net proceeds together with \$432 million of existing corporate cash to redeem \$800 million of 6<sup>3</sup>/<sub>8</sub>% Senior Notes which resulted in a \$73 million loss on early extinguishment of debt. This compares to \$12 million of losses on early extinguishment of debt as a result of the early extinguishment of \$100 million in repurchase agreements for the same period in 2014.

Total other income (expense) also includes corporate interest expense of \$21 million for three months ended March 31, 2015, compared to \$28 million for the same period in 2014. The decrease in corporate interest expense was driven by \$740 million in cumulative corporate debt reductions since the first quarter of 2014 which reduced our annual debt service cost from approximately \$110 million as of March 31, 2014 to \$50 million as of March 31, 2015.

***Income Tax Expense***

Income tax expense was \$23 million and \$47 million for the three months ended March 31, 2015 and 2014, respectively. The effective tax rate was 37% for the three months ended March 31, 2015, compared to 33% for the same period in 2014. Income tax expense for the three months ended March 31, 2014 included \$7 million of benefit related to a change to the New York state tax code and its impact on state deferred taxes. Excluding the impact of the change to the New York state tax code, the effective tax rate for the three months ended March 31, 2014 would have been 38%.

*Valuation Allowance*

We are required to establish a valuation allowance for deferred tax assets and record a corresponding increase to income tax expense if it is determined, based on evaluation of available evidence at the time the determination is made, that it is more likely than not that some or all of the deferred tax assets will not be realized. If we were to conclude that a valuation

[Table of Contents](#)

allowance was required, the resulting loss could have a material adverse effect on our financial condition and results of operations. As of March 31, 2015, we did not establish a valuation allowance against our federal deferred tax assets as we believe that it is more likely than not that all of these assets will 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; and corporate services. Balance sheet management includes the management of asset allocation; loans previously originated by the Company or purchased from third parties; deposits and customer payables; and credit, 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. For more information on our segments, see Note 14—Segment Information in Item 1. Consolidated Financial Statements (Unaudited).

**Trading and Investing**

The following table summarizes trading and investing financial information and key customer activity metrics as of and for the three months ended March 31, 2015 and 2014 (dollars in millions, except for key metrics):

|                               | Three Months Ended March 31, |        | Variance      |       |
|-------------------------------|------------------------------|--------|---------------|-------|
|                               | 2015                         | 2014   | 2015 vs. 2014 |       |
|                               |                              |        | Amount        | %     |
| Net operating interest income | \$ 165                       | \$ 140 | \$ 25         | 18 %  |
| Commissions                   | 114                          | 128    | (14)          | (11)% |
| Fees and service charges      | 52                           | 50     | 2             | 4 %   |
| Principal transactions        | —                            | 10     | (10)          | *     |
| Other revenues                | 8                            | 8      | —             | *     |
| Total net revenue             | 339                          | 336    | 3             | 1 %   |
| Total operating expense       | 203                          | 195    | 8             | 4 %   |
| Trading and investing income  | \$ 136                       | \$ 141 | \$ (5)        | (4)%  |

Key Customer Activity Metrics:

|  |           |           |          |       |
|--|-----------|-----------|----------|-------|
| DARTs  | 169,951   | 197,944   | (27,993) | (14)% |
| Average commission per trade                   | \$ 10.94  | \$ 10.64  | \$ 0.30  | 3 %   |
| Margin receivables (dollars in billions)       | \$ 8.2    | \$ 7.3    | \$ 0.9   | 12 %  |
| End of period brokerage accounts               | 3,182,639 | 3,069,961 | 112,678  | 4 %   |
| Net new brokerage accounts                     | 38,716    | 71,902    | (33,186) | (46)% |
| Annualized brokerage account attrition rate    | 8.8%      | 7.1%      | 1.7%     | *     |
| Customer assets (dollars in billions)          | \$ 299.4  | \$ 269.0  | \$ 30.4  | 11 %  |
| Net new brokerage assets (dollars in billions) | \$ 3.5    | \$ 4.1    | \$ (0.6) | (15)% |
| Brokerage related cash (dollars in billions)   | \$ 41.6   | \$ 40.1   | \$ 1.5   | 4 %   |

\* Percentage not meaningful.

The trading and investing segment offers products and services to individual retail investors, generating revenue from these customer relationships and from corporate services activities. This segment currently generates four main sources of revenue: net operating interest income; commissions; fees and service charges; 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 deposits and customer payables 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. 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. For the three months ended March 31, 2015 and 2014, our brokerage products contributed 80% and 81%, respectively, and our banking products contributed 20% and 19%, respectively, of total trading and investing net revenue.

[Table of Contents](#)

Trading and investing income decreased 4% to \$136 million for the three months ended March 31, 2015, compared to the same period in 2014, primarily driven by increased operating expenses.

Margin receivables, a key driver of net operating interest income, increased by \$0.9 billion to \$8.2 billion when compared to the same period in 2014. Brokerage related cash, which is one of our most profitable sources of funding, increased by \$1.5 billion to \$41.6 billion when compared to the same period in 2014. Trading and investing net operating interest income increased 18% to \$165 million for the three months ended March 31, 2015, driven primarily by the growth in margin receivables, coupled with increased revenue earned on securities lending activities when compared to the same period in 2014.

Trading and investing commissions revenue decreased 11% to \$114 million for the three months ended March 31, 2015, compared to the same period in 2014. The decrease in commissions was primarily due to a decrease in DARTs of 14% to 169,951 for the three months ended March 31, 2015, compared to the same period in 2014.

Trading and investing fees and service charges increased 4% to \$52 million for the three months ended March 31, 2015, compared to the same period in 2014. The increase in fees and services charges was driven primarily by increased advisor management fees and an increase in money market funds and sweep deposit revenue, offset by a decrease in order flow revenue. The increase in advisor management fees was driven by assets in managed accounts within our retirement, investing and savings products, which were \$3.2 billion at March 31, 2015, compared to \$2.6 billion at March 31, 2014.

There was no principal transactions revenue for the three months ended March 31, 2015, compared to \$10 million for the same period in 2014. Principal transactions were derived from our market making business in which we acted as a market-maker for our brokerage customers' orders as well as orders from third party customers. On February 10, 2014, we completed the sale of the market making business to an affiliate of Susquehanna and no longer generate principal transactions revenue.

Trading and investing operating expense increased 4% to \$203 million for the three months ended March 31, 2015, compared to the same period in 2014, primarily driven by increased compensation and benefits expenses to support our strategy of accelerating the growth of the core brokerage business.

As of March 31, 2015, we had approximately 3.2 million brokerage accounts, 1.3 million stock plan accounts and 0.4 million banking accounts.

**Balance Sheet Management**

The following table summarizes balance sheet management financial information and key financial metrics as of and for the three months ended March 31, 2015 and 2014 (dollars in millions):

|                                    | Three Months Ended |        | Variance      |       |
|------------------------------------|--------------------|--------|---------------|-------|
|                                    | March 31,          |        | 2015 vs. 2014 |       |
|                                    | 2015               | 2014   | Amount        | %     |
| Net operating interest income      | \$ 106             | \$ 123 | \$ (17)       | (14)% |
| Gains on loans and securities, net | 9                  | 15     | (6)           | (40)% |
| Other revenues                     | 2                  | 1      | 1             | 100 % |
| Total net revenue                  | 117                | 139    | (22)          | (16)% |
| Provision for loan losses          | 5                  | 4      | 1             | 25 %  |
| Total operating expense            | 36                 | 41     | (5)           | (12)% |
| Balance sheet management income    | \$ 76              | \$ 94  | \$ (18)       | (19)% |
| Key Financial Metrics:             |                    |        |               |       |
| Special mention loan delinquencies | \$ 191             | \$ 195 | \$ (4)        | (2)%  |
| Allowance for loan losses          | \$ 402             | \$ 403 | \$ (1)        | *     |

\* Percentage not meaningful.

The balance sheet management segment primarily generates revenue through net operating interest income. 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 deposits and customer payables to invest in available-for-sale and held-to-maturity securities, 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.

[Table of Contents](#)

The balance sheet management segment income decreased 19% to \$76 million for the three months ended March 31, 2015, compared to the same period in 2014, primarily driven by a decrease in net operating interest income.

The balance sheet management net operating interest income decreased 14% to \$106 million for the three months ended March 31, 2015, compared to the same period in 2014. The decrease for the three months ended March 31, 2015 was driven by the decrease in the interest earned on the loan portfolio as average loan balances decreased, partially offset by the growth in average balances of our held-to-maturity securities portfolio.

Gains on loans and securities, net decreased 40% to \$9 million for the three months ended March 31, 2015, compared to the same period in 2014. During the first quarter of 2014, we recognized a \$6 million gain on the sale of our remaining \$17 million in amortized cost of available-for-sale non-agency CMOs.

Provision for loan losses increased 25% to \$5 million for the three months ended March 31, 2015 compared to the same period in 2014. Provision for loan losses for the first quarter of 2015 and 2014 reflected continued improvement in economic conditions and loan portfolio run-off. The lower provision for loan losses in the first quarter of 2014 was mainly due to the \$11 million benefit we recognized from a settlement with a third party mortgage originator. The timing and magnitude of the provision for loan losses is affected by many factors and we anticipate variability, particularly as home equity lines of credit begin converting to amortizing loans.

Total balance sheet management operating expense decreased 12% to \$36 million for the three months ended March 31, 2015, compared to the same period in 2014. The decrease in operating expense for the three months ended March 31, 2015 resulted primarily from lower FDIC insurance premiums and reduced servicing expenses due to lower loan balances compared to the same period in 2014.

**Corporate/Other**

The following table summarizes corporate/other financial information for the three months ended March 31, 2015, and 2014 (dollars in millions):

|  | Three Months Ended March |         | Variance      |       |
|--|--------------------------|---------|---------------|-------|
|  | 31,                      |         | 2015 vs. 2014 |       |
|  | 2015                     | 2014    | Amount        | %     |
| Total net revenue                                | \$ —                     | \$ —    | \$ —          | *     |
| Compensation and benefits                        | 31                       | 24      | 7             | 29 %  |
| Professional services                            | 12                       | 12      | —             | *     |
| Occupancy and equipment                          | 4                        | 3       | 1             | 33 %  |
| Depreciation and amortization                    | 4                        | 5       | (1)           | (20)% |
| Facility restructuring and other exit activities | 4                        | 3       | 1             | 33 %  |
| Other operating expenses                         | 6                        | 7       | (1)           | (14)% |
| Total operating expense                          | 61                       | 54      | 7             | 13 %  |
| Operating loss                                   | (61)                     | (54)    | (7)           | 13 %  |
| Total other income (expense)                     | (88)                     | (37)    | (51)          | 138 % |
| Corporate/other loss                             | \$ (149)                 | \$ (91) | \$ (58)       | 64 %  |

\* 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.

The corporate/other loss before income taxes was \$149 million for the three months ended March 31, 2015, compared to \$91 million for the same period in 2014.

The operating loss increased 13% to \$61 million for the three months ended March 31, 2015, compared to the same period in 2014. The increase during the three months ended March 31, 2015 was primarily due to increased salaries expense driven by higher headcount and increased incentive compensation when compared to the same period in 2014.

During the three months ended March 31, 2015, we issued \$460 million of 4<sup>5</sup>/<sub>8</sub>% Senior Notes and we used the net proceeds together with \$432 million of existing corporate cash to redeem \$800 million of 6<sup>3</sup>/<sub>8</sub>% Senior Notes which resulted in a \$73 million loss on early extinguishment of debt in other income (expense). This compares to \$12 million of losses on early extinguishment of debt as a result of the early extinguishment of \$100 million in repurchase agreements for the same period in

[Table of Contents](#)

2014. Other income (expense) also includes corporate interest expense of \$21 million for three months ended March 31, 2015, compared to \$28 million for the same period in 2014. The decrease in corporate interest expense was driven by \$740 million in cumulative corporate debt reductions since the first quarter of 2014 which reduced our annual debt service cost from approximately \$110 million as of March 31, 2014 to \$50 million as of March 31, 2015.

**BALANCE SHEET OVERVIEW**

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

|   | March 31,<br>2015 | December 31,<br>2014 | Variance<br>2015 vs. 2014 |            |
|---|-------------------|----------------------|---------------------------|------------|
|   |                   |                      | Amount                    | %          |
| <b>Assets:</b>                                    |                   |                      |                           |            |
| Cash and equivalents                              | \$ 1,025          | \$ 1,783             | \$ (758)                  | (43)%      |
| Segregated cash                                   | 849               | 555                  | 294                       | 53 %       |
| Securities <sup>(1)</sup>                         | 26,358            | 24,636               | 1,722                     | 7 %        |
| Margin receivables                                | 8,220             | 7,675                | 545                       | 7 %        |
| Loans receivable, net                             | 5,664             | 5,979                | (315)                     | (5)%       |
| Investment in FHLB stock                          | 86                | 88                   | (2)                       | (2)%       |
| Other <sup>(2)</sup>                              | 4,623             | 4,814                | (191)                     | (4)%       |
| <b>Total assets</b>                               | <b>\$ 46,825</b>  | <b>\$ 45,530</b>     | <b>\$ 1,295</b>           | <b>3 %</b> |
| <b>Liabilities and shareholders' equity:</b>      |                   |                      |                           |            |
| Deposits  | \$ 26,272         | \$ 24,890            | \$ 1,382                  | 6 %        |
| Wholesale borrowings <sup>(3)</sup>               | 4,972             | 4,971                | 1                         | *          |
| Customer payables                                 | 6,293             | 6,455                | (162)                     | (3)%       |
| Corporate debt                                    | 1,025             | 1,366                | (341)                     | (25)%      |
| Other liabilities                                 | 2,810             | 2,473                | 337                       | 14 %       |
| <b>Total liabilities</b>                          | <b>41,372</b>     | <b>40,155</b>        | <b>1,217</b>              | <b>3 %</b> |
| <b>Shareholders' equity</b>                       | <b>5,453</b>      | <b>5,375</b>         | <b>78</b>                 | <b>1 %</b> |
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 46,825</b>  | <b>\$ 45,530</b>     | <b>\$ 1,295</b>           | <b>3 %</b> |

\* Percentage not meaningful.

(1) Includes balance sheet line items 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.

**Cash and Equivalents**

Cash and equivalents decreased by 43% to \$1.0 billion during the three months ended March 31, 2015. During the three months ended March 31, 2015, we issued \$460 million of 4 5/8% Senior Notes and we used the net proceeds together with \$432 million of existing corporate cash to redeem \$800 million of 6 3/8% Senior Notes.

**Segregated Cash**

Segregated cash increased by 53% to \$849 million during the three months ended March 31, 2015. 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.

[Table of Contents](#)

**Securities**

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

|  | March 31,<br>2015 | December 31,<br>2014 | Variance                |      |
|--|-------------------|----------------------|-------------------------|------|
|  |                   |                      | 2015 vs. 2014<br>Amount | %    |
| Available-for-sale securities:                         |                   |                      |                         |      |
| Debt securities:                                       |                   |                      |                         |      |
| Agency residential mortgage-backed securities and CMOs | \$ 12,701         | \$ 11,164            | \$ 1,537                | 14 % |
| Other debt securities                                  | 1,107             | 1,191                | (84)                    | (7)% |
| Total debt securities                                  | 13,808            | 12,355               | 1,453                   | 12 % |
| Publicly traded equity securities <sup>(1)</sup>       | 33                | 33                   | —                       | *    |
| Total available-for-sale securities                    | \$ 13,841         | \$ 12,388            | \$ 1,453                | 12 % |
| Held-to-maturity securities:                           |                   |                      |                         |      |
| Agency residential mortgage-backed securities and CMOs | \$ 9,899          | \$ 9,793             | \$ 106                  | 1 %  |
| Other debt securities                                  | 2,618             | 2,455                | 163                     | 7 %  |
| Total held-to-maturity securities                      | \$ 12,517         | \$ 12,248            | \$ 269                  | 2 %  |
| Total investments in securities                        | \$ 26,358         | \$ 24,636            | \$ 1,722                | 7 %  |

\* Percentage not meaningful.

(1) Publicly traded equity securities consisted of investments in a mutual fund related to the Community Reinvestment Act.

Securities represented 56% and 54% of total assets at March 31, 2015 and December 31, 2014, respectively. We classify debt securities as available-for-sale or held-to-maturity based on our investment strategy and management's assessment of our intent and ability to hold the debt securities until maturity. The increase in total investments in securities during the three months ended March 31, 2015 was primarily due to the purchase of agency residential mortgage-backed securities and CMOs as a result of increased customer deposits and the reinvestment of funds as our loan portfolios pay down.

**Loans Receivable, Net**

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

|                             | March 31,<br>2015 | December 31,<br>2014 | Variance                |      |
|-----------------------------|-------------------|----------------------|-------------------------|------|
|                             |                   |                      | 2015 vs. 2014<br>Amount | %    |
| One- to four-family         | \$ 2,927          | \$ 3,060             | \$ (133)                | (4)% |
| Home equity                 | 2,681             | 2,834                | (153)                   | (5)% |
| Consumer and other          | 426               | 455                  | (29)                    | (6)% |
| Unamortized premiums, net   | 32                | 34                   | (2)                     | (6)% |
| Allowance for loan losses   | (402)             | (404)                | 2                       | *    |
| Total loans receivable, net | \$ 5,664          | \$ 5,979             | \$ (315)                | (5)% |

\* Percentage not meaningful.

Loans receivable, net decreased 5% to \$5.7 billion at March 31, 2015 from \$6.0 billion at December 31, 2014. We are continuing our strategy of reducing balance sheet risk by allowing the loan portfolio to pay down, which we plan to do for the foreseeable future. However, as our portfolio ages and we gather substantive performance history for loans converting from interest-only to amortizing, we will continue to assess the economic environment and the value of our portfolio in the marketplace. While it is our intention to continue to hold these loans, if the markets improve our strategy could change.

[Table of Contents](#)

**Deposits**

Deposits are summarized as follows (dollars in millions):

|   | March 31,<br>2015 | December 31,<br>2014 | Variance<br>2015 vs. 2014 |       |
|---|-------------------|----------------------|---------------------------|-------|
|   |                   |                      | Amount                    | %     |
| Sweep deposits                          | \$ 20,472         | \$ 19,119            | \$ 1,353                  | 7 %   |
| Complete savings deposits               | 3,728             | 3,753                | (25)                      | (1)%  |
| Checking deposits                       | 1,198             | 1,137                | 61                        | 5 %   |
| Other money market and savings deposits | 831               | 833                  | (2)                       | *     |
| Time deposits                           | 43                | 48                   | (5)                       | (10)% |
| Total deposits                          | \$ 26,272         | \$ 24,890            | \$ 1,382                  | 6 %   |

\* Percentage not meaningful.

Deposits represented 64% and 62% of total liabilities at March 31, 2015 and December 31, 2014, respectively. At March 31, 2015, 89% of our customer deposits were covered by FDIC insurance. Deposits provide the benefit of lower interest costs compared with wholesale funding alternatives.

The majority of the deposits balance, specifically sweep deposits, is included in brokerage related cash and reported as a customer activity metric of \$41.6 billion and \$41.1 billion at March 31, 2015 and December 31, 2014, respectively. The total brokerage related cash balance is summarized as follows (dollars in millions):

|   | March 31,<br>2015 | December 31,<br>2014 | Variance<br>2015 vs. 2014 |      |
|---|-------------------|----------------------|---------------------------|------|
|   |                   |                      | Amount                    | %    |
| Deposits  | \$ 26,272         | \$ 24,890            | \$ 1,382                  | 6 %  |
| Less: bank related cash <sup>(1)</sup>                | (5,800)           | (5,771)              | (29)                      | 1 %  |
| Sweep deposits at banking subsidiaries <sup>(2)</sup> | 20,472            | 19,119               | 1,353                     | 7 %  |
| Customer payables                                     | 6,293             | 6,455                | (162)                     | (3)% |
| Customer assets held by third parties <sup>(3)</sup>  | 14,863            | 15,520               | (657)                     | (4)% |
| Total brokerage related cash <sup>(4)</sup>           | \$ 41,628         | \$ 41,094            | \$ 534                    | 1 %  |

(1) Bank related cash includes complete savings deposits, checking deposits, other money market and savings deposits and time deposits.

(2) 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.

(3) Customer assets held by third parties are not reflected on our consolidated balance sheet and are not immediately available for liquidity purposes.

(4) Increases in brokerage related cash generally indicate that the use of our products and services by existing and new brokerage customers is expanding.

The components of customer assets held by third parties are as follows (dollars in millions):

|   | March 31,<br>2015 | December 31,<br>2014 | Variance<br>2015 vs. 2014 |       |
|---|-------------------|----------------------|---------------------------|-------|
|   |                   |                      | Amount                    | %     |
| Money market fund                                     | \$ 7,610          | \$ 7,169             | \$ 441                    | 6 %   |
| Sweep deposits at unaffiliated financial institutions | 3,588             | 4,744                | (1,156)                   | (24)% |
| Subtotal  | 11,198            | 11,913               | (715)                     | (6)%  |
| Municipal funds and other                             | 3,665             | 3,607                | 58                        | 2 %   |
| Customer assets held by third parties                 | \$ 14,863         | \$ 15,520            | \$ (657)                  | (4)%  |

At March 31, 2015, our customers held \$14.9 billion of assets at third party financial institutions, including third party banks and money market funds. Approximately 70% of these off-balance sheet assets resulted from our deleveraging efforts that we completed in prior periods. We maintain the ability to transfer the majority of these customer assets back on the balance sheet with appropriate notification to the third party financial institutions and customer consent, as appropriate. Customer assets held by third parties included \$3.6 billion and \$4.7 billion of customer sweep deposits at March 31, 2015 and December 31, 2014, respectively, in the extended insurance sweep deposit account program ("ESDA") that we have in place for brokerage customers.

[Table of Contents](#)

The ESDA program utilized E\*TRADE Bank in combination with additional third party program banks to allow certain customers the ability to insure at least \$1,250,000 of the cash they hold in the ESDA program.

During the first quarter of 2015, we converted approximately \$15.1 billion of customer assets in the ESDA program to the new sweep deposit platform that will enable us to more efficiently manage our balance sheet size. During the first quarter of 2015, we utilized this platform to direct \$1.3 billion of customer sweep deposits to our balance sheet.

**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,<br>2015 | December 31,<br>2014 | Variance<br>2015 vs. 2014 |       |
|--|-------------------|----------------------|---------------------------|-------|
|  |                   |                      | Amount                    | %     |
| Securities sold under agreements to repurchase                         | \$ 3,668          | \$ 3,672             | \$ (4)                    | *     |
| FHLB advances  | 920               | 920                  | —                         | *     |
| Total securities sold under agreements to repurchase and FHLB advances | 4,588             | 4,592                | (4)                       | *     |
| Subordinated debentures  | 428               | 428                  | —                         | *     |
| Fair value hedge adjustments and deferred costs                        | (44)              | (49)                 | 5                         | (10)% |
| Total wholesale borrowings   | \$ 4,972          | \$ 4,971             | \$ 1                      | *     |

\* Percentage not meaningful.

Wholesale borrowings represented 12% of total liabilities at both March 31, 2015 and December 31, 2014. Securities sold under agreements to repurchase and FHLB advances are the primary wholesale funding sources of E\*TRADE Bank. During 2015, we expect securities sold under agreements to repurchase to decrease by approximately \$365 million due to planned decreases in the forecasted issuances of debt.

We currently have \$4.6 billion of securities sold under agreements to repurchase and FHLB advances that are scheduled to run off over the next eight years. While these sources of funding are more expensive than other sources available to us, such as customer deposits, the estimated pre-tax cost to eliminate these obligations as of March 31, 2015 would be approximately \$0.5 billion. Our intent remains to replace wholesale borrowings with customer deposits as the planned decreases in the forecasted issuances of wholesale borrowings occur; however, as we continue to execute on our capital plan and consider the best uses of excess capital, our intent could change. For additional information on our use of hedge accounting, see Note 7—Accounting for Derivative Instruments and Hedging Activities in Item 1. Consolidated Financial Statements (Unaudited).

**Corporate Debt**

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

|                                     | Face Value | Discount | Net      |
|-------------------------------------|------------|----------|----------|
| <b>March 31, 2015</b>               |            |          |          |
| Interest-bearing notes:             |            |          |          |
| 5 3/8% Notes, due 2022              | \$ 540     | \$ (6)   | \$ 534   |
| 4 5/8% Notes, due 2023              | 460        | (6)      | 454      |
| Total interest-bearing notes        | 1,000      | (12)     | 988      |
| Non-interest-bearing debt:          |            |          |          |
| 0% Convertible debentures, due 2019 | 37         | —        | 37       |
| Total corporate debt                | \$ 1,037   | \$ (12)  | \$ 1,025 |

[Table of Contents](#)

|                                     | Face Value | Discount | Net      |
|-------------------------------------|------------|----------|----------|
| <b>December 31, 2014</b>            |            |          |          |
| Interest-bearing notes:             |            |          |          |
| 6 3/8% Notes, due 2019              | \$ 800     | \$ (5)   | \$ 795   |
| 5 3/8% Notes, due 2022              | 540        | (7)      | 533      |
| Total interest-bearing notes        | 1,340      | (12)     | 1,328    |
| Non-interest-bearing debt:          |            |          |          |
| 0% Convertible debentures, due 2019 | 38         | —        | 38       |
| Total corporate debt                | \$ 1,378   | \$ (12)  | \$ 1,366 |

During the three months ended March 31, 2015, we issued an aggregate principal amount of \$460 million in 4 5/8% Notes, due 2023. We used the net proceeds from the issuance of the 4 5/8% Notes, along with \$432 million of existing corporate cash, to redeem all of the outstanding 6 3/8% Notes due 2019. We also entered into an amendment to our senior secured revolving credit facility to increase commitments thereunder by \$50 million. We now have available capacity for borrowing under the credit facility of \$250 million, which expires in November 2017. We have the ability to borrow against the credit facility for working capital and general corporate purposes. As of March 31, 2015, there was no outstanding balance under this credit facility.

**Other Liabilities**

Other liabilities increased \$0.3 billion to \$2.8 billion due primarily to an increase of \$0.2 billion in deposits received for securities loaned during the three months ended March 31, 2015.

**Shareholders' Equity**

The activity in shareholders' equity during the three months ended March 31, 2015 is summarized as follows (dollars in millions):

|   | Common Stock /<br>Additional Paid-In<br>Capital | Accumulated Deficit /<br>Other<br>Comprehensive Loss | Total    |
|---|---|--|----------|
| Beginning balance, December 31, 2014          | \$ 7,353  | \$ (1,978)   | \$ 5,375 |
| Net income                                    | —   | 40   | 40       |
| Net change from available-for-sale securities | —   | 33   | 33       |
| Net change from cash flow hedging instruments | —   | 5  | 5        |
| Ending balance, March 31, 2015                | \$ 7,353  | \$ (1,900)   | \$ 5,453 |

**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 and our broker-dealer subsidiaries. The objective of our policies is to ensure that we can meet our corporate, banking and broker-dealer liquidity needs under both normal operating conditions and under periods of stress in the financial markets.

**Liquidity**

Our corporate liquidity needs are primarily driven by capital needs at E\*TRADE Bank and E\*TRADE Clearing as well as by the amount of principal and interest due on our corporate debt. Our banking and brokerage liquidity needs are driven primarily by the level and volatility of our customer activity. Management maintains a 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 are the key sources of liquidity that impact our ability to meet our liquidity needs: corporate cash, bank cash, deposits, securities lending, customer payables, unused FHLB borrowing capacity and the revolving credit facility at the parent company.

## [Table of Contents](#)

### *Consolidated Cash and Equivalents*

The consolidated cash and equivalents balance decreased by \$758 million to \$1.0 billion at March 31, 2015 when compared to December 31, 2014. The majority of this balance was cash held in regulated subsidiaries, primarily E\*TRADE Bank, outlined as follows (dollars in millions):

|  | March 31,<br>2015 | December 31,<br>2014 | March 31,<br>2014 |
|--|-------------------|----------------------|-------------------|
| Corporate cash                                 | \$ 258            | \$ 233               | \$ 525            |
| Bank cash <sup>(1)</sup>                       | 606               | 1,523                | 1,036             |
| E*TRADE Securities                             | 134               | N/A                  | N/A               |
| International brokerage and other cash         | 27                | 27                   | 24                |
| <b>Total consolidated cash and equivalents</b> | <b>\$ 1,025</b>   | <b>\$ 1,783</b>      | <b>\$ 1,585</b>   |

(1) E\*TRADE Securities was moved from under E\*TRADE Bank effective February 1, 2015 and we plan to move E\*TRADE Clearing in the second half of 2015. At March 31, 2015, December 31, 2014 and March 31, 2014, bank cash included \$131 million, \$235 million and \$224 million, respectively, of cash held by E\*TRADE Clearing, which is a broker-dealer subsidiary of E\*TRADE Bank. Bank cash also included \$529 million and \$366 million of cash held by E\*TRADE Securities at December 31, 2014 and March 31, 2014, respectively.

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 or notification. 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.

Corporate cash ended the first quarter of 2015 at \$258 million, up from \$233 million at December 31, 2014. Corporate cash included dividends of \$75 million from E\*TRADE Bank and \$434 million from E\*TRADE Securities to the parent company during the first quarter of 2015. We used \$432 million of corporate cash along with the net proceeds from the issuance of \$460 million of corporate debt to redeem \$800 million in aggregate principal amount of our higher cost corporate debt. This transaction decreased our annual debt service costs from \$80 million to \$50 million and reduced our total corporate debt to \$1.0 billion. We target corporate cash to cover at least two times our scheduled annual corporate debt service payments and scheduled maturities over the next 12 months. As such, our target is approximately \$100 million as we do not have any corporate debt with scheduled maturities in the next 12 months.

The senior secured revolving credit facility enhances our ability to meet liquidity needs at the parent company. During the first quarter of 2015, we increased our revolving credit facility at the parent company by an additional \$50 million to a total available line of credit of \$250 million. We have the ability to borrow against this revolving credit facility for working capital and general corporate purposes. The revolving credit facility contains certain maintenance covenants, including the requirement for the parent company to maintain unrestricted cash of at least \$100 million. At March 31, 2015, there was no outstanding balance under this credit facility. Additionally, the parent company had \$369 million in net deferred tax assets, which will ultimately become sources of corporate cash as the parent company's subsidiaries reimburse the parent company for the use of its deferred tax assets.

### *Deposits*

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. While in recent periods we have transferred customer sweep deposits to third party banks that participate in our ESDA program as well as to third party money market funds, we maintain the ability to transfer the majority of these off-balance sheet deposits back to E\*TRADE Bank with appropriate notification to the third party financial institutions and customer consent, as appropriate. During the first quarter of 2015, we converted approximately \$15.1 billion of customer assets in the ESDA program to the new sweep deposit platform that will enable us to more efficiently manage our balance sheet size. During the first quarter of 2015, we utilized this platform to direct \$1.3 billion of customer sweep deposits to our balance sheet. We also have the ability to generate liquidity in the form of additional deposits by raising the yield on our customer deposit products.

Refer to Other Sources of Liquidity within this section for information on additional sources of liquidity outside of deposits.

## [Table of Contents](#)

### *Liquidity Available from Subsidiaries*

Liquidity available to us from our subsidiaries is limited by regulatory requirements. 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 and its subsidiaries require regulatory approval prior to the payment of dividends to the parent company. As E\*TRADE Securities is no longer a subsidiary of E\*TRADE Bank, it can pay dividends to the parent company with proper regulatory notifications.

### *Other Sources of Liquidity*

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, 2015, E\*TRADE Bank had approximately \$2.6 billion and \$0.9 billion in additional collateralized borrowing capacity with the FHLB and the Federal Reserve Bank, respectively.

We rely on securities lending, customer payables, an unsecured line of credit with E\*TRADE Bank and uncommitted lines of credit with unaffiliated banks to provide liquidity and finance margin lending for E\*TRADE Clearing. E\*TRADE Clearing's uncommitted lines of credit are subject to approval when utilized and there were no outstanding balances at March 31, 2015.

### *Capital Resources*

Executing on our capital plan remains a priority for us. We submitted an initial capital plan to the OCC and Federal Reserve in 2012 and have subsequently updated the plan annually. The plan includes 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. We believe we have made important progress since we laid out our capital plan, as evidenced by:

- \$550 million in quarterly dividends that our regulators approved from E\*TRADE Bank since 2013, including \$75 million during the three months ended March 31, 2015; and
- Regulatory approval to operate E\*TRADE Bank at a 9.0% Tier 1 leverage ratio.

We also received regulatory approval to move our U.S. broker-dealers, E\*TRADE Securities and E\*TRADE Clearing, out from under E\*TRADE Bank. E\*TRADE Securities was moved from under E\*TRADE Bank in February 2015 and subsequently paid a dividend of \$434 million to the parent company. We plan to move E\*TRADE Clearing out from under E\*TRADE Bank in the second half of 2015, at which point it will require the necessary standalone capital and liquidity levels to operate. We are taking the necessary capital and liquidity steps and are focused on establishing these levels prior to moving E\*TRADE Clearing out from under E\*TRADE Bank. The revised organizational structure provides increased capital flexibility as it enables us to dividend excess regulatory capital at our broker-dealers to the parent company. In addition, starting in the second quarter of 2015, we plan to request regulatory approval to issue a dividend each quarter equivalent to E\*TRADE Bank's net income from the previous quarter.

### *Bank Capital Requirements*

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 impacted us as the parent company was not previously subject to regulatory capital requirements. These requirements became effective for us during the first quarter of 2015, subject to a phase-in period for certain requirements over several years, as further explained below. We are currently in compliance with the Basel III capital requirements now applicable to us and we have no plans to raise additional capital as a result of these new requirements.

In July 2013, the U.S. Federal banking agencies finalized a rule to implement Basel III in the U.S., which provides an updated framework for the calculation of a banking organization's regulatory capital and risk-weighted assets. The Basel III rule established Common Equity Tier 1 capital as a new tier of capital, raised the minimum thresholds for required capital, increased minimum required risk-based capital ratios, narrowed the eligibility criteria for regulatory capital instruments, provided for new regulatory capital deductions and adjustments, and modified methods for calculating risk-weighted assets (the denominator of risk-based capital ratios) by, among other things, strengthening counterparty credit risk capital requirements.

The Basel III final rule also introduces a capital conservation buffer that limits a banking organization's ability to make capital distributions and discretionary bonus payments to executive officers if a banking organization fails to maintain a Common Equity Tier 1 capital conservation buffer of more than 2.5%, on a fully phased-in basis, of total risk-weighted assets above each of the following minimum risk-based capital ratio requirements: Common Equity Tier 1 (4.5%), Tier 1 (6.0%), and

[Table of Contents](#)

total risk-based capital (8.0%). This requirement will begin to take effect on January 1, 2016, and will be fully phased in by 2019. Certain new regulatory deductions and adjustments are subject to a phase-in period over the next four years, beginning at 40% in 2015 and fully implemented at 100% in 2018.

Several elements of the final rule had a meaningful impact to us. The vast majority of our margin receivables qualified for 0% risk-weighting and we included a larger portion of our deferred tax assets in regulatory capital, both having a favorable impact on our current capital ratios. A portion of this benefit was offset as we are phasing out trust preferred securities from the parent company's capital. In addition, in the first quarter of 2015 we made the one-time permanent election to exclude accumulated other comprehensive income from the calculation of Common Equity Tier 1 capital.

At March 31, 2015, our regulatory capital ratios for E\*TRADE Bank were well above the minimum ratios required to be "well capitalized." E\*TRADE Bank's capital ratios are calculated as follows (dollars in millions):

|  | March 31,<br>2015 <sup>(1)</sup> | December 31,<br>2014 <sup>(1)</sup> | March 31,<br>2014 <sup>(1)</sup> |
|--|----------------------------------|-------------------------------------|----------------------------------|
| E*TRADE Bank shareholders' equity <sup>(2)</sup>   | \$ 4,165                         | \$ 6,102                            | \$ 5,857                         |
| Deduct:  |                                  |                                     |                                  |
| Losses in other comprehensive income on available-for-sale debt securities and cash flow hedges, net of tax              | (216)                            | (255)                               | (384)                            |
| Goodwill and other intangible assets, net of deferred tax liabilities  | 38                               | 1,467                               | 1,513                            |
| Disallowed deferred tax assets   | 66                               | 342                                 | 532                              |
| E*TRADE Bank Tier 1 capital/Common Equity Tier 1 capital <sup>(2)(3)</sup>   | 4,277                            | 4,548                               | 4,196                            |
| Add:   |                                  |                                     |                                  |
| Allowable allowance for loan losses  | 130                              | 224                                 | 233                              |
| E*TRADE Bank total capital <sup>(2)</sup>  | \$ 4,407                         | \$ 4,772                            | \$ 4,429                         |
| E*TRADE Bank average/total assets <sup>(2)(4)</sup>  | \$ 43,622                        | \$ 44,672                           | \$ 45,323                        |
| Deduct:  |                                  |                                     |                                  |
| Disallowed deferred tax assets   | 66                               | 342                                 | 532                              |
| Goodwill and other intangible assets, net of deferred tax liabilities  | 38                               | 1,467                               | 1,513                            |
| Other  | —                                | (13)                                | (102)                            |
| E*TRADE Bank adjusted average/total assets for leverage capital purposes <sup>(1)</sup>                                  | \$ 43,518                        | \$ 42,876                           | \$ 43,380                        |
| E*TRADE Bank total risk-weighted assets <sup>(2)(5)</sup>  | \$ 10,095                        | \$ 17,717                           | \$ 18,439                        |
| E*TRADE Bank Tier 1 leverage ratio (Tier 1 capital / Adjusted total assets for leverage capital purposes) <sup>(2)</sup> | 9.8%                             | 10.6%                               | 9.7%                             |
| E*TRADE Bank Tier 1 capital / Total risk-weighted assets <sup>(2)</sup>  | 42.4%                            | 25.7%                               | 22.8%                            |
| E*TRADE Bank total capital / Total risk-weighted assets <sup>(2)</sup>   | 43.7%                            | 26.9%                               | 24.0%                            |
| E*TRADE Bank Common Equity Tier 1 capital <sup>(3)</sup> / Total risk-weighted assets <sup>(2)</sup>                     | 42.4%                            | 25.7%                               | 22.8%                            |

(1) Due to the change in regulatory requirements described above, the 2015 ratios were calculated under Basel III requirements and the 2014 ratios were calculated under Basel I requirements.

(2) Amounts presented for E\*TRADE Bank in 2015 exclude E\*TRADE Securities as of February 1, 2015, the date the subsidiary was transferred out from under E\*TRADE Bank.

(3) Common Equity Tier 1 capital under Basel III replaced Tier 1 common capital. Prior to Basel III becoming effective, E\*TRADE Bank's Tier 1 common ratio was a non-GAAP measure that management believes is an important measure of capital strength.

(4) As of March 31, 2015, E\*TRADE Bank's Tier 1 Leverage ratio was calculated using average total assets. Prior to Basel III becoming effective for E\*TRADE Bank, E\*TRADE Bank's Tier 1 Leverage ratio was calculated using end of period total assets.

(5) 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. Due to the change in regulatory requirements described above, in 2015 the vast majority of our margin receivables qualified for 0% risk-weighting.

## Table of Contents

At March 31, 2015, our regulatory capital ratios for E\*TRADE Financial were well above the minimum ratios required to be "well capitalized." E\*TRADE Financial's capital ratios are calculated as follows (dollars in millions):

|  | March 31,<br>2015 <sup>(1)</sup> | December 31,<br>2014 <sup>(1)</sup> | March 31,<br>2014 <sup>(1)</sup> |
|--|----------------------------------|-------------------------------------|----------------------------------|
| E*TRADE Financial shareholders' equity   | \$ 5,453                         | \$ 5,375                            | \$ 5,032                         |
| Deduct:  |                                  |                                     |                                  |
| Losses in other comprehensive income on available-for-sale debt securities and cash flow hedges, net of tax            | (216)                            | (255)                               | (384)                            |
| Goodwill and other intangible assets, net of deferred tax liabilities  | 1,451                            | 1,592                               | 1,638                            |
| Disallowed deferred tax assets   | 645                              | 1,008                               | 1,138                            |
| Other <sup>(2)</sup>   | (108)                            | —                                   | —                                |
| E*TRADE Financial Common Equity Tier 1 capital <sup>(3)</sup>  | 3,681                            | 3,030                               | 2,640                            |
| Add:   |                                  |                                     |                                  |
| Qualifying restricted core capital elements (trust preferred securities) <sup>(2)</sup>                                | —                                | 433                                 | 433                              |
| E*TRADE Financial Tier 1 capital   | 3,681                            | 3,463                               | 3,073                            |
| Add:   |                                  |                                     |                                  |
| Allowable allowance for loan losses  | 140                              | 223                                 | 232                              |
| Non-qualifying capital instruments subject to phase-out (trust preferred securities) <sup>(2)</sup>                    | 325                              | —                                   | —                                |
| E*TRADE Financial total capital  | \$ 4,146                         | \$ 3,686                            | \$ 3,305                         |
| E*TRADE Financial average total assets   |                                  |                                     |                                  |
|  | \$ 45,931                        | \$ 45,445                           | \$ 46,382                        |
| Deduct:  |                                  |                                     |                                  |
| Goodwill and other intangible assets, net of deferred tax liabilities  | 1,451                            | 1,592                               | 1,638                            |
| Disallowed deferred tax assets   | 645                              | 1,008                               | 1,138                            |
| Other <sup>(2)</sup>   | (108)                            | —                                   | —                                |
| E*TRADE Financial adjusted average total assets for leverage capital purposes  | \$ 43,943                        | \$ 42,845                           | \$ 43,606                        |
| E*TRADE Financial total risk-weighted assets <sup>(4)</sup>  |                                  |                                     |                                  |
|  | \$ 10,523                        | \$ 17,683                           | \$ 18,403                        |
| E*TRADE Financial Tier 1 leverage ratio (Tier 1 capital / Adjusted average total assets for leverage capital purposes) |                                  |                                     |                                  |
|  | 8.4%                             | 8.1%                                | 7.0%                             |
| E*TRADE Financial Tier 1 capital / Total risk-weighted assets  |                                  |                                     |                                  |
|  | 35.0%                            | 19.6%                               | 16.7%                            |
| E*TRADE Financial total capital / Total risk-weighted assets   |                                  |                                     |                                  |
|  | 39.4%                            | 20.8%                               | 18.0%                            |
| E*TRADE Financial Common Equity Tier 1 capital <sup>(3)</sup> / Total risk-weighted assets                             |                                  |                                     |                                  |
|  | 35.0%                            | 17.1%                               | 14.3%                            |

(1) Due to the change in regulatory requirements described above, the 2015 ratios were calculated under Basel III requirements. The 2014 capital ratios were non-GAAP measures as the parent company was not yet held to regulatory capital requirements and were calculated based on the Federal Reserve's well-capitalized requirements then applicable to bank holding companies. Management believes the non-GAAP ratios are an important measure of the Company's capital strength and managed capital against ratios then applicable to bank holding companies in preparation for the application of these requirements.

(2) As a result of applying the transition provisions under Basel III, the Company included 25% of the TRUPs in the calculation of E\*TRADE Financial's Tier 1 capital and 75% of the TRUPs in the calculation of E\*TRADE Financial's total capital. Prior to Basel III becoming effective for E\*TRADE Financial, the Company included 100% of the TRUPs in E\*TRADE Financial's Tier 1 capital due to the regulatory agencies' delay in the implementation of the TRUPs phase-out until January 1, 2015.

(3) Common Equity Tier 1 capital under Basel III replaced Tier 1 common capital.

(4) 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. Due to the change in regulatory requirements described above, in 2015 the vast majority of our margin receivables qualified for 0% risk-weighting.

## [Table of Contents](#)

### *Broker-Dealer Capital Requirements*

Our broker-dealer subsidiaries are subject to capital requirements determined by their respective regulators. At March 31, 2015, all of our brokerage subsidiaries met their minimum net capital requirements, ending the period with excess net capital of \$728 million. As E\*TRADE Clearing is a subsidiary of E\*TRADE Bank, the \$632 million of excess net capital at E\*TRADE Clearing was also included in the capital of E\*TRADE Bank at March 31, 2015.

### *Stress Testing*

On October 9, 2012, the U.S. Federal banking agencies, including the OCC and the Federal Reserve, issued final rules implementing provisions of the Dodd-Frank Act that require banking organizations with total consolidated assets of more than \$10 billion but less than \$50 billion to conduct annual company-run stress tests, report the results to their primary federal regulator and the Federal Reserve and publish a summary of the results. Under the rules, stress tests must be conducted using certain scenarios (baseline, adverse and severely adverse), which the OCC and Federal Reserve will publish by November 15 of each year.

Under the OCC stress test regulations, E\*TRADE Bank is required to conduct stress testing using the prescribed stress-testing methodologies. E\*TRADE Bank submitted the results of its second annual stress test prior to March 31, 2015, as required. The OCC will analyze and provide feedback on the quality of E\*TRADE Bank's stress test process and results. E\*TRADE Bank will be required to publish summary results of its annual stress test between June 15 and June 30 each year, beginning with its second annual stress test in 2015.

Under the final Federal Reserve regulations, the parent company will be required to conduct its first stress test using financial statement data as of September 30, 2016. We will be required to report the results of its first stress test to the Federal Reserve on or before March 31, 2017, and to disclose a summary of its first stress test results between June 15 and June 30, 2017.

### *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 keys 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. In 2015, we will continue to enhance our risk management culture and capabilities. As of June 1, 2014, our risk management framework became required to satisfy the risk committee requirement for publicly traded bank holding companies with total consolidated assets of greater than \$10 billion and less than \$50 billion, contained in the Federal Reserve's enhanced prudential standards for bank holding companies and foreign banking organizations. Our framework, as described below, is in compliance with all applicable requirements.

We have a Board-approved Risk Appetite Statement ("RAS") which we disseminate to employees. The RAS 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 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 conditions.

## [Table of Contents](#)

- *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, 2014. 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, 2014.

### ***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, and we are continuing our strategy of reducing balance sheet risk by allowing the loan portfolio to pay down.
- 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 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***

Our credit risk operations team 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 reduced our exposure to open home equity lines from a high of over \$7 billion in 2007 to \$149 million at March 31, 2015.

We have loan modification programs that focus on the mitigation of potential losses in the one- to four- family and home equity mortgage loan portfolio by targeting borrowers experiencing financial difficulties. During the three months ended March 31, 2015 and 2014, we modified \$3 million and \$7 million, respectively, of one- to four-family loans and \$2 million and \$4 million, respectively, of home equity loans, under these programs in which the modifications were considered TDRs. We also recently offered a loan modification program to a subset of borrowers with home equity lines of credit whose original loan terms provided the borrowers the option to accelerate their date of conversion to amortizing loans. As certain terms of our offer represented economic concessions, such as longer amortization periods than were in the original loan agreements, this program resulted in \$14 million of TDRs and \$44 million of modifications not classified as TDRs during the first quarter of 2015.

We also process minor modifications on a number of loans through traditional collections actions taken in the normal course of servicing delinquent accounts. Minor modifications resulting in an insignificant delay in the timing of payments are not considered economic concessions and therefore are not classified as TDRs. At March 31, 2015 and December 31, 2014, we

## [Table of Contents](#)

had \$24 million and \$25 million, respectively, of mortgage loans with minor modifications that were not considered TDRs. Approximately 9% and 5% of these loans were classified as nonperforming at March 31, 2015 and December 31, 2014, respectively. We currently do not have any active loan modification program for consumer and other loans.

Currently, our entire loans receivable portfolio is serviced by other companies. To reduce vendor operational and regulatory risk, we have an initiative to assess our servicing relationships and, where appropriate, consolidate loan servicing or transfer certain mortgage loans to servicers that specialize in managing troubled assets. During the three months ended March 31, 2015, we completed servicer transfers of \$942 million of mortgage loans as a result of this initiative. At March 31, 2015, \$3.6 billion gross unpaid principal balance of our mortgage loans were held at 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 compared to the expected credit performance of these same loans if they had not been transferred.

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. Approximately \$2 million of loans were repurchased by or settled with the original sellers during the three months ended March 31, 2015, for a total of \$459 million of loans that were repurchased, including global settlements, since we actively started reviewing our purchased loan portfolio beginning in 2008. While we may continue to pursue loans to be repurchased by or settled with the original sellers, we consider this effort to be substantially complete.

## CONCENTRATIONS OF CREDIT RISK

### Loans

One- to four-family loans include interest-only loans for a five to ten year period, followed by an amortizing period ranging from 20 to 25 years. At March 31, 2015, 42% of our one- to four-family portfolio were not yet amortizing. However, during the trailing twelve months ended March 31, 2015, approximately 16% of these borrowers made voluntary annual principal payments of at least \$2,500 and slightly over a third of those borrowers made voluntary annual principal payments of at least \$10,000.

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 14% of the home equity loan portfolio was in the first lien position and we held both the first and second lien positions in less than 1% of the home equity loan portfolio at March 31, 2015. The home equity loan portfolio consisted of approximately 19% of home equity installment loans and approximately 81% of home equity lines of credit at March 31, 2015.

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. Approximately 7% of this portfolio will require the borrowers to repay the loan in full at the end of the draw period, commonly referred to as "balloon loans." At March 31, 2015, 79% of the home equity line of credit portfolio had not converted from the interest-only draw period and had not begun amortizing. However, during the trailing twelve months ended March 31, 2015, approximately 40% of these borrowers made annual principal payments of at least \$500 on their home equity lines of credit and slightly under half of those borrowers reduced their principal balance by at least \$2,500.

The following table outlines when one- to four-family and home equity lines of credit convert to amortizing by percentage of the one- to four-family and home equity line of credit portfolios, respectively, at March 31, 2015:

| <u>Period of Conversion to Amortizing Loan</u> | <u>% of One- to Four-Family Portfolio</u> | <u>% of Home Equity Line of Credit Portfolio</u> |
|--|---|--|
| Already amortizing                             | 58%                                       | 21%  |
| Through December 31, 2015                      | 4%  | 23%  |
| Year ending December 31, 2016                  | 16%                                       | 42%  |
| Year ending December 31, 2017 or later         | 22%                                       | 14%  |

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 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, we believe that loan type, LTV/CLTV ratios 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. Credit scores and

[Table of Contents](#)

LTV/CLTV are updated on at least a quarterly basis. For the consumer and other loan portfolio, we track and review delinquency status to predict and monitor credit risk on at least a quarterly basis.

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

| <u>Current LTV/CLTV(1)</u>               | <u>One- to Four-Family</u> |                          | <u>Home Equity</u>    |                          |
|--|----------------------------|--------------------------|-----------------------|--------------------------|
|  | <u>March 31, 2015</u>      | <u>December 31, 2014</u> | <u>March 31, 2015</u> | <u>December 31, 2014</u> |
| <=80%                                    | \$ 1,706                   | \$ 1,757                 | \$ 1,033              | \$ 1,081                 |
| 80%-100%                                 | 765                        | 807                      | 706                   | 755                      |
| 100%-120%                                | 285                        | 311                      | 531                   | 557                      |
| >120%                                    | 171                        | 185                      | 411                   | 441                      |
| Total mortgage loans receivable          | <u>\$ 2,927</u>            | <u>\$ 3,060</u>          | <u>\$ 2,681</u>       | <u>\$ 2,834</u>          |
| Average estimated current LTV/CLTV (2)   | 78%                        | 79%                      | 92%                   | 92%                      |
| Average LTV/CLTV at loan origination (3) | 71%                        | 71%                      | 80%                   | 80%                      |

- (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. For home equity loans in the second lien position, the original balance of the first lien loan at origination date and updated valuations on the property underlying the loan are used to calculate CLTV. 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 home equity installment loans and maximum available line for home equity lines of credit.

| <u>Current FICO (1)</u>         | <u>One- to Four-Family</u> |                          | <u>Home Equity</u>    |                          |
|---------------------------------|----------------------------|--------------------------|-----------------------|--------------------------|
|                                 | <u>March 31, 2015</u>      | <u>December 31, 2014</u> | <u>March 31, 2015</u> | <u>December 31, 2014</u> |
| >=720                           | \$ 1,661                   | \$ 1,734                 | \$ 1,394              | \$ 1,487                 |
| 719 - 700                       | 278                        | 296                      | 273                   | 292                      |
| 699 - 680                       | 245                        | 260                      | 231                   | 238                      |
| 679 - 660                       | 181                        | 197                      | 196                   | 203                      |
| 659 - 620                       | 228                        | 237                      | 249                   | 258                      |
| <620                            | 334                        | 336                      | 338                   | 356                      |
| Total mortgage loans receivable | <u>\$ 2,927</u>            | <u>\$ 3,060</u>          | <u>\$ 2,681</u>       | <u>\$ 2,834</u>          |

- (1) FICO scores are updated on a quarterly basis; however, there were approximately \$48 million and \$49 million of one- to four-family loans at March 31, 2015 and December 31, 2014, respectively, and \$4 million of home equity loans for both periods, for which the updated FICO scores were not available. For these loans, the current FICO distribution included the most recent FICO scores where available, otherwise the original FICO score was used.

Approximately 47% of our mortgage loans receivable were full documentation loans at both March 31, 2015 and December 31, 2014, with the remaining being low or no documentation. The average age of our mortgage loans receivable was 9.2 years and 8.9 years at March 31, 2015 and December 31, 2014, respectively.

Approximately 38% of our mortgage loans receivable were concentrated in California at both March 31, 2015 and December 31, 2014. No other state had concentrations of mortgage loans that represented 10% or more of our mortgage loans receivable at March 31, 2015 and December 31, 2014.

*Allowance for Loan Losses*

The allowance for loan losses is management's estimate of probable losses inherent in the loan portfolio at 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

[Table of Contents](#)

life of loans modified as TDRs. The general allowance for loan losses also includes a qualitative component to account for a variety of factors that present additional uncertainty that may not be fully considered in the quantitative loss model but are factors we believe may impact the level of credit losses.

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

|   | One- to Four-Family |                   | Home Equity    |                   | Consumer and Other |                   | Total          |                   |
|---|---------------------|-------------------|----------------|-------------------|--------------------|-------------------|----------------|-------------------|
|   | March 31, 2015      | December 31, 2014 | March 31, 2015 | December 31, 2014 | March 31, 2015     | December 31, 2014 | March 31, 2015 | December 31, 2014 |
| General reserve:                                    |                     |                   |                |                   |                    |                   |                |                   |
| Quantitative component                              | \$ 10               | \$ 11             | \$ 275         | \$ 281            | \$ 9               | \$ 9              | \$ 294         | \$ 301            |
| Qualitative component                               | 10                  | 7                 | 23             | 29                | 2                  | 1                 | 35             | 37                |
| Specific valuation allowance                        | 11                  | 9                 | 62             | 57                | —                  | —                 | 73             | 66                |
| Total allowance for loan losses                     | \$ 31               | \$ 27             | \$ 360         | \$ 367            | \$ 11              | \$ 10             | \$ 402         | \$ 404            |
| Allowance as a % of loans receivable <sup>(1)</sup> | 1.0%                | 0.9%              | 13.4%          | 12.9%             | 2.7%               | 2.1%              | 6.6%           | 6.3%              |

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

*Troubled Debt Restructurings*

TDRs include two categories of loans: (1) loan modifications completed under our loss mitigation programs in which economic concessions were granted to borrowers experiencing financial difficulty, and (2) loans that have been charged-off based on the estimated current value of the underlying property less estimated selling costs due to bankruptcy notification even if the loan has not been modified under the Company's programs. The following table shows total TDRs by category at March 31, 2015 and December 31, 2014 (dollars in millions):

|                          | Loans Modified as TDRs <sup>(1)</sup> | Bankruptcy Loans | Total TDRs |
|--------------------------|---------------------------------------|------------------|------------|
| <b>March 31, 2015</b>    |                                       |                  |            |
| One- to four-family      | \$ 180                                | \$ 129           | \$ 309     |
| Home equity              | 180                                   | 45               | 225        |
| Total                    | \$ 360                                | \$ 174           | \$ 534     |
| <b>December 31, 2014</b> |                                       |                  |            |
| One- to four-family      | \$ 185                                | \$ 131           | \$ 316     |
| Home equity              | 169                                   | 48               | 217        |
| Total                    | \$ 354                                | \$ 179           | \$ 533     |

(1) Includes loans modified as TDRs that also had received a bankruptcy notification of \$43 million and \$42 million at March 31, 2015 and December 31, 2014, respectively.

The following table shows total TDRs by delinquency category at March 31, 2015 and December 31, 2014 (dollars in millions):

[Table of Contents](#)

|                          | TDRs<br>Current | TDRs 30-89<br>Days<br>Delinquent | TDRs 90-179<br>Days<br>Delinquent | TDRs 180+<br>Days<br>Delinquent | Total Recorded<br>Investment<br>in<br>TDRs |
|--------------------------|-----------------|----------------------------------|-----------------------------------|---------------------------------|--|
| <b>March 31, 2015</b>    |                 |                                  |                                   |                                 |  |
| One- to four-family      | \$ 219          | \$ 30                            | \$ 10                             | \$ 50                           | \$ 309                                     |
| Home equity              | 184             | 17                               | 6                                 | 18                              | 225  |
| Total                    | \$ 403          | \$ 47                            | \$ 16                             | \$ 68                           | \$ 534                                     |
| <b>December 31, 2014</b> |                 |                                  |                                   |                                 |  |
| One- to four-family      | \$ 232          | \$ 24                            | \$ 12                             | \$ 48                           | \$ 316                                     |
| Home equity              | 178             | 14                               | 6                                 | 19                              | 217  |
| Total                    | \$ 410          | \$ 38                            | \$ 18                             | \$ 67                           | \$ 533                                     |

TDRs on accrual status, which are current and have made six or more consecutive payments, were \$233 million and \$248 million at March 31, 2015 and December 31, 2014, respectively.

*Troubled Debt Restructurings – Loan Modifications*

We believe the distinction between loans modified as TDRs and total TDRs, which include bankruptcy loans, is important. Our loan modification programs focus on the mitigation of potential losses through making an economic concession to a borrower, whereas with loans for which we have received bankruptcy notification we have not taken any loss mitigation actions. The following table shows loans modified as TDRs by delinquency category at March 31, 2015 and December 31, 2014 (dollars in millions):

|                          | Modifications<br>Current | Modifications<br>30-89 Days<br>Delinquent | Modifications<br>90-179 Days<br>Delinquent | Modifications<br>180+ Days<br>Delinquent | Total Recorded<br>Investment in<br>Modifications |
|--------------------------|--------------------------|---|--|--|--|
| <b>March 31, 2015</b>    |                          |   |  |  |  |
| One- to four-family      | \$ 142                   | \$ 16                                     | \$ 8                                       | \$ 14                                    | \$ 180   |
| Home equity              | 154                      | 12  | 5  | 9  | 180  |
| Total                    | \$ 296                   | \$ 28                                     | \$ 13                                      | \$ 23                                    | \$ 360   |
| <b>December 31, 2014</b> |                          |   |  |  |  |
| One- to four-family      | \$ 152                   | \$ 14                                     | \$ 7                                       | \$ 12                                    | \$ 185   |
| Home equity              | 145                      | 10  | 5  | 9  | 169  |
| Total                    | \$ 297                   | \$ 24                                     | \$ 12                                      | \$ 21                                    | \$ 354   |

The following table shows loans modified as TDRs and the specific valuation allowance by loan portfolio as well as the percentage of total expected losses at March 31, 2015 and December 31, 2014 (dollars in millions):

|                          | Recorded<br>Investment in<br>Modifications<br>before<br>Charge-offs | Charge-offs | Recorded<br>Investment in<br>Modifications | Specific<br>Valuation<br>Allowance | Net Investment in<br>Modifications | Specific Valuation<br>Allowance as a %<br>of Modifications | Total<br>Expected<br>Losses |
|--------------------------|---|-------------|--|------------------------------------|------------------------------------|--|-----------------------------|
| <b>March 31, 2015</b>    |   |             |  |                                    |                                    |  |                             |
| One- to four-family      | \$ 225  | \$ (45)     | \$ 180                                     | \$ (11)                            | \$ 169                             | 6%   | 24%                         |
| Home equity              | 312   | (132)       | 180  | (62)                               | 118                                | 35%  | 62%                         |
| Total                    | \$ 537  | \$ (177)    | \$ 360                                     | \$ (73)                            | \$ 287                             | 20%  | 46%                         |
| <b>December 31, 2014</b> |   |             |  |                                    |                                    |  |                             |
| One- to four-family      | \$ 231  | \$ (46)     | \$ 185                                     | \$ (9)                             | \$ 176                             | 5%   | 24%                         |
| Home equity              | 305   | (136)       | 169  | (57)                               | 112                                | 34%  | 63%                         |
| Total                    | \$ 536  | \$ (182)    | \$ 354                                     | \$ (66)                            | \$ 288                             | 19%  | 46%                         |

The recorded investment in loans modified as TDRs includes the charge-offs related to certain loans that were written down to the estimated current value of the underlying property less estimated selling costs. These charge-offs were recorded on modified loans that were delinquent in excess of 180 days, in bankruptcy, or 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.

[Table of Contents](#)

Included in allowance for loan losses was a specific valuation allowance of \$73 million and \$66 million that was established for loans modified as TDRs at March 31, 2015 and December 31, 2014, respectively. The specific valuation allowance for these individually impaired loans represents the forecasted losses over the remaining life of the loan, including the economic concession to the borrower.

The total expected loss on loans modified as TDRs includes both the previously recorded charge-offs and the specific valuation allowance. Total expected losses on loans modified as TDRs remained at 46% as a percentage of total recorded investments in modifications before charge-offs at March 31, 2015 and December 31, 2014.

*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, 2015 and 2014 (dollars in millions):

|  | Charge-offs    | Recoveries <sup>(1)</sup> | Net Charge-Offs | % of Average<br>Loans<br>(Annualized) |
|--|----------------|---------------------------|-----------------|---------------------------------------|
| <b>Three Months Ended March 31, 2015</b> |                |                           |                 |                                       |
| One- to four-family                      | \$ (1)         | \$ —                      | \$ (1)          | 0.10%                                 |
| Home equity                              | (10)           | 5                         | (5)             | 0.69%                                 |
| Consumer and Other                       | (3)            | 2                         | (1)             | 0.94%                                 |
| Total                                    | <u>\$ (14)</u> | <u>\$ 7</u>               | <u>\$ (7)</u>   | 0.43%                                 |
| <b>Three Months Ended March 31, 2014</b> |                |                           |                 |                                       |
| One- to four-family                      | \$ (43)        | \$ 11                     | \$ (32)         | 3.00%                                 |
| Home equity                              | (24)           | 5                         | (19)            | 2.20%                                 |
| Consumer and Other                       | (5)            | 2                         | (3)             | 2.05%                                 |
| Total                                    | <u>\$ (72)</u> | <u>\$ 18</u>              | <u>\$ (54)</u>  | 2.61%                                 |

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

Loan losses are recognized when, based on management's estimate, 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 has received bankruptcy notification, regardless of whether or not the property is in foreclosure, and charge off the amount of the loan balance in excess of the estimated current value of the underlying property less estimated selling costs. Modified loans considered TDRs are charged off when they are identified as collateral dependent based on certain terms of the modification, which includes assigning a higher level of risk to loans in which the LTV or CLTV is greater than 110% or 125%, respectively, a borrower's credit score is less than 600 and certain types of modifications, such as interest-only payments. Closed-end 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, 2015 compared to 2014 decreased by \$47 million. The higher net charge-offs during the first quarter of 2014 was mainly due to a charge-off of \$42 million related to our transfer of one- to four-family loans modified as TDRs to held-for-sale, which was partially offset by the \$11 million of benefit recorded from a settlement with a third party mortgage originator. The decrease in net charge-offs for the three months ended March 31, 2015 compared to 2014 also reflected the improving economic conditions, as evidenced by home price improvement and portfolio run-off. The timing and magnitude of charge-offs are affected by many factors and we anticipate variability from quarter to quarter, particularly as home equity lines of credit begin converting to amortizing loans.

[Table of Contents](#)*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 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. The following table shows the comparative data for loans delinquent 90 to 179 days (dollars in millions):

|  | <b>March 31, 2015</b> | <b>December 31, 2014</b> |
|--|-----------------------|--------------------------|
| One- to four-family  | \$ 25                 | \$ 28                    |
| Home equity  | 27                    | 29                       |
| Consumer and other   | 1                     | 1                        |
| Total loans delinquent 90-179 days                                     | \$ 53                 | \$ 58                    |
| Loans delinquent 90-179 days as a percentage of gross loans receivable | 0.9%                  | 0.9%                     |

In addition, 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):

|  | <b>March 31, 2015</b> | <b>December 31, 2014</b> |
|--|-----------------------|--------------------------|
| One- to four-family  | \$ 107                | \$ 88                    |
| Home equity  | 77                    | 60                       |
| Consumer and other   | 7                     | 7                        |
| Total special mention loans  | \$ 191                | \$ 155                   |
| Special mention loans receivable as a percentage of gross loans receivable | 3.2%                  | 2.4%                     |

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 was approximately 94% for a trailing twelve-month period as of March 31, 2015.

During the three months ended March 31, 2015, special mention loans increased by \$36 million to \$191 million mainly due to servicer transfers. We expect that some of these loans will return to current as borrowers adjust to the new servicers.

*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 (including loans in bankruptcy) and certain junior liens that have a delinquent senior lien. The following table shows the comparative data for nonperforming loans and assets at March 31, 2015 and December 31, 2014 (dollars in millions):

[Table of Contents](#)

|   | March 31, 2015 | December 31, 2014 |
|---|----------------|-------------------|
| One- to four-family   | \$ 292         | \$ 294            |
| Home equity   | 175            | 165               |
| Consumer and other  | 1              | 1                 |
| <b>Total nonperforming loans receivable</b>   | <b>468</b>     | <b>460</b>        |
| Real estate owned and other repossessed assets, net   | 35             | 38                |
| <b>Total nonperforming assets, net</b>  | <b>\$ 503</b>  | <b>\$ 498</b>     |
| Nonperforming loans receivable as a percentage of gross loans receivable  | 7.8%           | 7.2%              |
| One- to four-family allowance for loan losses as a percentage of one- to four-family nonperforming loans receivable | 10.4%          | 9.1%              |
| Home equity allowance for loan losses as a percentage of home equity nonperforming loans receivable                 | 205.3%         | 222.5%            |
| Consumer and other allowance for loan losses as a percentage of consumer and other nonperforming loans receivable   | 1,361.2%       | 774.6%            |
| Total allowance for loan losses as a percentage of total nonperforming loans receivable                             | 85.9%          | 87.8%             |

Nonperforming assets, net increased slightly by \$5 million to \$503 million at March 31, 2015 when compared to December 31, 2014. This increase was attributed primarily to our recent offer of a loan modification program to a subset of borrowers with home equity lines of credit whose original loan terms provided the borrowers the option to accelerate their date of conversion to amortizing loans. As certain terms of our offer represented economic concessions, such as longer amortization periods than were in the original loan agreements, this program resulted in \$14 million of TDRs during the first quarter of 2015. Also see Risk Management - *Loss Mitigation on the Loan Portfolio* for additional information.

*Securities*

We focus primarily on security type and credit rating to monitor credit risk in our securities portfolios. 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 at March 31, 2015. The amortized cost of these securities accounted for over 99% of our total securities portfolio at March 31, 2015. We review the remaining debt securities that were not backed by the U.S. government or its agencies according to their credit ratings from S&P, Moody's and Fitch where available. At March 31, 2015, all municipal bonds and corporate bonds were rated investment grade (defined as a rating equivalent to a Moody's rating of "Baa3" or higher, or a S&P or Fitch rating of "BBB-" or higher).

**SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The 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 Part II. Item 8. Financial Statements and Supplementary Data in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 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 critical 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 Part II. Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Summary of Critical Accounting Policies and Estimates in our Annual Report on Form 10-K for the year ended December 31, 2014.

**GLOSSARY OF TERMS**

*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.

## [Table of Contents](#)

*Adjusted average total assets*—Assets composed of average total assets plus/(less) unrealized losses (gains) on available-for-sale securities and cash flow hedges, less disallowed deferred tax assets, goodwill and certain other intangible assets, and other applicable adjustments.

*Agency*—U.S. Government sponsored enterprises 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.

*APIC*—Additional paid-in capital.

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

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

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

*BCBS*—International Basel Committee on Banking Supervision.

*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.

*Brokerage related cash*—Customer sweep deposits held at banking subsidiaries, customer payables and customer assets held by third parties.

*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.

*CFTC*—Commodity Futures Trading Commission.

*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.

*Consumer loans*—Loans that are secured by real personal property, such as recreational vehicles.

*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, deposits and customer payables, as well as customer assets held by third parties and vested unexercised options.

*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 options and swaps.

*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*—Assets such as loans, available-for-sale securities, held-to-maturity securities, margin receivables, 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.

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

## [Table of Contents](#)

*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.

*ESDA*—Extended insurance sweep deposit accounts.

*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.

*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.

*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).

*Interest rate cap*—An option 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 option 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.

*LCR*—Liquidity Coverage Ratio.

*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).

*LTV*—Loan-to-value.

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

*NFA*—National Futures Association.

*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 (real estate owned). 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 (including loans in bankruptcy) 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.

*OCC*—Office of the Comptroller of the Currency.

*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.

## [Table of Contents](#)

*OTTI*—Other-than-temporary impairment.

*Real estate owned 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.

*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.

*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.

*Sweep deposit accounts*—Accounts with the functionality to transfer customer deposit balances to and from a FDIC insured account.

*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, less disallowed servicing and deferred tax assets, goodwill and certain other intangible assets, and other applicable adjustments.

*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, 2014 and as updated in this report.

#### ***Interest Rate Risk***

Our exposure to interest rate risk is related primarily to interest-earning assets and interest-bearing liabilities, all 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 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.

## [Table of Contents](#)

- 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, 2015, 90% of our total assets were enterprise interest-earning assets.

At March 31, 2015, approximately 60% 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 and/or discounts are recognized immediately in operating interest income. Depending on the timing of the prepayment, these adjustments to operating income may impact anticipated yields. The 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, securities lending, and the revolving credit facility and corporate debt at the parent company.

Deposits 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"), "Payor Swaptions" and "Receiver Swaptions." Caps mitigate the market risk associated with increases in 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 7—Accounting for Derivative Instruments and Hedging Activities in Item 1. Consolidated Financial Statements (Unaudited).

### ***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, 2015 and December 31, 2014 and held 99% of enterprise interest-bearing liabilities at both March 31, 2015 and December 31, 2014. The sensitivity of EVE at March 31, 2015 and December 31, 2014 and the limits established by E\*TRADE Bank's Board of Directors are listed below (dollars in millions):

Change in EVE

| Parallel Change in Interest Rates<br>(basis points) <sup>(1)</sup> | Change in EVE  |                           |             |                   |                           |             |
|--|----------------|---------------------------|-------------|-------------------|---------------------------|-------------|
|  | March 31, 2015 |                           |             | December 31, 2014 |                           |             |
|  | Amount         | Percentage <sup>(2)</sup> | Board Limit | Amount            | Percentage <sup>(2)</sup> | Board Limit |
| +300   | \$ (747)       | (13.6)%                   | (25)%       | \$ (626)          | (11.6)%                   | (25)%       |
| +200   | \$ (338)       | (6.2)%                    | (15)%       | \$ (353)          | (6.6)%                    | (15)%       |
| +100   | \$ (109)       | (2.0)%                    | (7)%        | \$ (127)          | (2.4)%                    | (7)%        |
| -100   | \$ (52)        | (1.0)%                    | (7)%        | \$ (21)           | (0.4)%                    | (7)%        |

(1) Due to historically low interest rates for all yield curve points, the minus 200 and 300 basis points scenarios are not produced for the periods ended March 31, 2015 and December 31, 2014.

(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 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.

**PART I—FINANCIAL INFORMATION**  
**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF INCOME**  
(In millions, except share data and per share amounts)  
(Unaudited)

|   | <b>Three Months Ended March 31,</b> |                |
|---|-------------------------------------|----------------|
|   | <b>2015</b>                         | <b>2014</b>    |
| <b>Revenue:</b>   |                                     |                |
| Operating interest income                                   | \$ 316                              | \$ 319         |
| Operating interest expense                                  | (45)                                | (56)           |
| Net operating interest income                               | <u>271</u>                          | <u>263</u>     |
| Commissions   | 114                                 | 128            |
| Fees and service charges                                    | 52                                  | 50             |
| Principal transactions                                      | —                                   | 10             |
| Gains on loans and securities, net                          | 9                                   | 15             |
| Other revenues  | 10                                  | 9              |
| Total non-interest income                                   | <u>185</u>                          | <u>212</u>     |
| Total net revenue   | <u>456</u>                          | <u>475</u>     |
| Provision for loan losses                                   | 5                                   | 4              |
| <b>Operating expense:</b>                                   |                                     |                |
| Compensation and benefits                                   | 113                                 | 98             |
| Advertising and market development                          | 34                                  | 34             |
| Clearing and servicing                                      | 24                                  | 28             |
| FDIC insurance premiums                                     | 18                                  | 24             |
| Professional services                                       | 27                                  | 24             |
| Occupancy and equipment                                     | 21                                  | 18             |
| Communications  | 19                                  | 18             |
| Depreciation and amortization                               | 20                                  | 21             |
| Amortization of other intangibles                           | 5                                   | 5              |
| Facility restructuring and other exit activities            | 4                                   | 3              |
| Other operating expenses                                    | 15                                  | 17             |
| Total operating expense                                     | <u>300</u>                          | <u>290</u>     |
| Income before other income (expense) and income tax expense | 151                                 | 181            |
| <b>Other income (expense):</b>                              |                                     |                |
| Corporate interest expense                                  | (21)                                | (28)           |
| Losses on early extinguishment of debt                      | (73)                                | (12)           |
| Equity in income of investments and other                   | 6                                   | 3              |
| Total other income (expense)                                | <u>(88)</u>                         | <u>(37)</u>    |
| Income before income tax expense                            | 63                                  | 144            |
| Income tax expense  | 23                                  | 47             |
| Net income  | <u>\$ 40</u>                        | <u>\$ 97</u>   |
| Basic earnings per share                                    | <u>\$ 0.14</u>                      | <u>\$ 0.34</u> |
| Diluted earnings per share                                  | <u>\$ 0.14</u>                      | <u>\$ 0.33</u> |
| <b>Shares used in computation of per share data:</b>        |                                     |                |
| Basic (in thousands)  | 289,741                             | 288,051        |
| Diluted (in thousands)                                      | 294,722                             | 293,819        |

See accompanying notes to consolidated financial statements

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

|  | <b>Three Months Ended March 31,</b> |               |
|--|-------------------------------------|---------------|
|  | <b>2015</b>                         | <b>2014</b>   |
| Net income   | \$ 40                               | \$ 97         |
| Other comprehensive income                         |                                     |               |
| Available-for-sale securities:                     |                                     |               |
| Unrealized gains (losses), net <sup>(1)</sup>      | 39                                  | 81            |
| Reclassification into earnings, net <sup>(2)</sup> | (6)                                 | (12)          |
| Net change from available-for-sale securities      | 33                                  | 69            |
| Cash flow hedging instruments:                     |                                     |               |
| Unrealized gains (losses), net <sup>(3)</sup>      | (11)                                | (16)          |
| Reclassification into earnings, net <sup>(4)</sup> | 16                                  | 21            |
| Net change from cash flow hedging instruments      | 5                                   | 5             |
| Other comprehensive income                         | 38                                  | 74            |
| Comprehensive income                               | <u>\$ 78</u>                        | <u>\$ 171</u> |

(1) Amounts are net of provision for income taxes of \$24 million and \$50 million for the three months ended March 31, 2015 and 2014, respectively.

(2) Amounts are net of provision for income taxes of \$4 million and \$7 million for the three months ended March 31, 2015 and 2014, respectively.

(3) Amounts are net of benefit from income taxes of \$6 million and \$11 million for the three months ended March 31, 2015 and 2014, respectively.

(4) Amounts are net of benefit from income taxes of \$10 million and \$14 million for the three months ended March 31, 2015 and 2014, respectively.

See accompanying notes to the consolidated financial statements

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

|  | <u>March 31,</u><br><u>2015</u> | <u>December 31,</u><br><u>2014</u> |
|--|---------------------------------|------------------------------------|
| <b><u>ASSETS</u></b>   |                                 |                                    |
| Cash and equivalents   | \$ 1,025                        | \$ 1,783                           |
| Cash required to be segregated under federal or other regulations  | 849                             | 555                                |
| Available-for-sale securities  | 13,841                          | 12,388                             |
| Held-to-maturity securities (fair value of \$12,866 and \$12,476 at March 31, 2015 and December 31, 2014, respectively)  | 12,517                          | 12,248                             |
| Margin receivables   | 8,220                           | 7,675                              |
| Loans receivable, net (net of allowance for loan losses of \$402 and \$404 at March 31, 2015 and December 31, 2014, respectively)  | 5,664                           | 5,979                              |
| Investment in FHLB stock   | 86                              | 88                                 |
| Property and equipment, net  | 241                             | 245                                |
| Goodwill   | 1,792                           | 1,792                              |
| Other intangibles, net   | 189                             | 194                                |
| Other assets   | 2,401                           | 2,583                              |
| Total assets   | <u>\$ 46,825</u>                | <u>\$ 45,530</u>                   |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>   |                                 |                                    |
| <b>Liabilities:</b>  |                                 |                                    |
| Deposits   | \$ 26,272                       | \$ 24,890                          |
| Securities sold under agreements to repurchase   | 3,668                           | 3,672                              |
| Customer payables  | 6,293                           | 6,455                              |
| FHLB advances and other borrowings   | 1,304                           | 1,299                              |
| Corporate debt   | 1,025                           | 1,366                              |
| Other liabilities  | 2,810                           | 2,473                              |
| Total liabilities  | <u>41,372</u>                   | <u>40,155</u>                      |
| Commitments and contingencies (see Note 13)  |                                 |                                    |
| <b>Shareholders' equity:</b>   |                                 |                                    |
| Common stock, \$0.01 par value, shares authorized: 400,000,000 at March 31, 2015 and December 31, 2014; shares issued and outstanding: 289,897,529 and 289,272,576 at March 31, 2015 and December 31, 2014, respectively | 3                               | 3                                  |
| Additional paid-in-capital ("APIC")  | 7,350                           | 7,350                              |
| Accumulated deficit  | (1,689)                         | (1,729)                            |
| Accumulated other comprehensive loss   | (211)                           | (249)                              |
| Total shareholders' equity   | <u>5,453</u>                    | <u>5,375</u>                       |
| Total liabilities and shareholders' equity   | <u>\$ 46,825</u>                | <u>\$ 45,530</u>                   |

See accompanying notes to the consolidated financial statements

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

|   | Common Stock |             | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Shareholders'<br>Equity |
|---|--------------|-------------|----------------------------------|------------------------|---|----------------------------------|
|   | Shares       | Amount      |                                  |                        |   |                                  |
| <b>Balance, December 31, 2014</b>   | 289          | \$ 3        | \$ 7,350                         | \$ (1,729)             | \$ (249)                                      | \$ 5,375                         |
| Net income  | —            | —           | —                                | 40                     | —   | 40                               |
| Other comprehensive income  | —            | —           | —                                | —                      | 38  | 38                               |
| Exercise of stock options and related tax effects                             | —            | —           | 2                                | —                      | —   | 2                                |
| Issuance of restricted stock, net of forfeitures and retirements to pay taxes | 1            | —           | (9)                              | —                      | —   | (9)                              |
| Share-based compensation  | —            | —           | 7                                | —                      | —   | 7                                |
| <b>Balance at March 31, 2015</b>  | <u>290</u>   | <u>\$ 3</u> | <u>\$ 7,350</u>                  | <u>\$ (1,689)</u>      | <u>\$ (211)</u>                               | <u>\$ 5,453</u>                  |

|   | Common Stock |             | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Shareholders'<br>Equity |
|---|--------------|-------------|----------------------------------|------------------------|---|----------------------------------|
|   | Shares       | Amount      |                                  |                        |   |                                  |
| <b>Balance, December 31, 2013</b>   | 287          | \$ 3        | \$ 7,328                         | \$ (2,022)             | \$ (453)                                      | \$ 4,856                         |
| Net income  | —            | —           | —                                | 97                     | —   | 97                               |
| Other comprehensive income  | —            | —           | —                                | —                      | 74  | 74                               |
| Conversion of convertible debentures  | —            | —           | 1                                | —                      | —   | 1                                |
| Exercise of stock options and related tax effects                             | 1            | —           | 6                                | —                      | —   | 6                                |
| Issuance of restricted stock, net of forfeitures and retirements to pay taxes | 1            | —           | (10)                             | —                      | —   | (10)                             |
| Share-based compensation  | —            | —           | 8                                | —                      | —   | 8                                |
| <b>Balance at March 31, 2014</b>  | <u>289</u>   | <u>\$ 3</u> | <u>\$ 7,333</u>                  | <u>\$ (1,925)</u>      | <u>\$ (379)</u>                               | <u>\$ 5,032</u>                  |

See accompanying notes to the consolidated financial statements

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

|  | Three Months Ended March 31, |              |
|--|------------------------------|--------------|
|  | 2015                         | 2014         |
| <b>Cash flows from operating activities:</b>   |                              |              |
| Net income   | \$ 40                        | \$ 97        |
| Adjustments to reconcile net income to net cash used in operating activities:              |                              |              |
| Provision for loan losses  | 5                            | 4            |
| Depreciation and amortization (including discount amortization and accretion)              | 89                           | 79           |
| Net gains on loans and securities, net   | (9)                          | (15)         |
| Equity in income of investments and other  | (6)                          | (3)          |
| Losses on early extinguishment of debt   | 5                            | —            |
| Share-based compensation   | 7                            | 8            |
| Deferred taxes   | 21                           | 36           |
| Other  | (1)                          | —            |
| Net effect of changes in assets and liabilities:   |                              |              |
| (Increase) decrease in cash required to be segregated under federal or other regulations   | (294)                        | 85           |
| Increase in margin receivables   | (545)                        | (993)        |
| Decrease in customer payables  | (162)                        | (50)         |
| Proceeds from sales and repayments of loans held-for-sale                                  | —                            | 4            |
| Decrease in other assets   | 162                          | 46           |
| Increase in other liabilities  | 158                          | 559          |
| Net cash used in operating activities  | <u>(530)</u>                 | <u>(143)</u> |
| <b>Cash flows from investing activities:</b>   |                              |              |
| Purchases of available-for-sale securities   | (2,002)                      | (279)        |
| Proceeds from sales, maturities of and principal payments on available-for-sale securities | 764                          | 1,281        |
| Purchases of held-to-maturity securities   | (699)                        | (1,302)      |
| Proceeds from maturities of and principal payments on held-to-maturity securities          | 380                          | 227          |
| Net decrease in loans receivable   | 303                          | 341          |
| Capital expenditures for property and equipment  | (16)                         | (7)          |
| Proceeds from sale of G1 Execution Services, Inc.  | —                            | 76           |
| Cash transferred on sale of G1 Execution Services, Inc.                                    | —                            | (9)          |
| Proceeds from sale of real estate owned and repossessed assets                             | 7                            | 10           |
| Net cash flow from derivatives hedging assets  | —                            | (6)          |
| Other  | 2                            | 5            |
| Net cash (used in) provided by investing activities  | <u>(1,261)</u>               | <u>337</u>   |

**E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CASH FLOWS—(Continued)**  
(In millions)  
(Unaudited)

|  | Three Months Ended March 31, |          |
|--|------------------------------|----------|
|  | 2015                         | 2014     |
| <b>Cash flows from financing activities:</b>                           |                              |          |
| Net increase (decrease) in deposits                                    | \$ 1,382                     | \$ (222) |
| Net decrease in securities sold under agreements to repurchase         | (4)                          | (198)    |
| Advances from FHLB   | 270                          | 220      |
| Payments on advances from FHLB   | (270)                        | (220)    |
| Net proceeds from issuance of senior notes                             | 460                          | —        |
| Payments on senior notes   | (800)                        | —        |
| Net cash flow from derivatives hedging liabilities                     | —                            | (32)     |
| Other  | (5)                          | 5        |
| Net cash provided by (used in) financing activities                    | 1,033                        | (447)    |
| Decrease in cash and equivalents                                       | (758)                        | (253)    |
| Cash and equivalents, beginning of period                              | 1,783                        | 1,838    |
| Cash and equivalents, end of period                                    | \$ 1,025                     | \$ 1,585 |
| <b>Supplemental disclosures:</b>                                       |                              |          |
| Cash paid for interest   | \$ 108                       | \$ 53    |
| Cash paid for income taxes   | \$ 3                         | \$ —     |
| <b>Non-cash investing and financing activities:</b>                    |                              |          |
| Transfers of loans held-for-investment to loans held-for-sale          | \$ —                         | \$ 795   |
| Transfers from loans to other real estate owned and repossessed assets | \$ 8                         | \$ 16    |
| Transfers from other real estate owned and repossessed assets to loans | \$ —                         | \$ 16    |
| Conversion of convertible debentures to common stock                   | \$ —                         | \$ 1     |

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 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, to retail investors.

As of December 31, 2014, the Company's two U.S. broker-dealers, E\*TRADE Clearing and E\*TRADE Securities, were operating subsidiaries of E\*TRADE Bank, a wholly-owned operating subsidiary of E\*TRADE Financial Corporation. The Company recently received regulatory approval to move both E\*TRADE Clearing and E\*TRADE Securities out from under E\*TRADE Bank. E\*TRADE Securities was moved out from under E\*TRADE Bank in February 2015 and the Company plans to move E\*TRADE Clearing in the second half of 2015. For additional information, see Note 12—Regulatory Requirements.

**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 has the ability to exercise significant influence but in which the Company does not possess control are generally accounted for by the equity method. Entities in which the Company does not have the ability to exercise significant influence are generally carried at cost. However, investments in marketable equity securities where the Company does not have the ability to exercise significant influence over the entities are accounted for as available-for-sale equity securities. The Company also evaluates its initial and continuing involvement with certain entities to determine if the Company is required to consolidate the entities under the variable interest entity ("VIE") model. This evaluation is based on a qualitative assessment of whether the Company is the primary beneficiary of the VIE, which requires the Company to possess both: 1) the power to direct activities that most significantly impact the economic performance of the VIE; and 2) the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

The Company's consolidated financial statements are prepared in accordance with GAAP. Intercompany accounts and transactions are eliminated in consolidation. Beginning in the first quarter of 2015, the Company reclassified the revenue earned on customer assets held by third parties from operating interest income to fees and service charges and prior periods 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.

The Company reports corporate interest expense separately from operating interest expense. The Company believes reporting these 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 expense is generated from the operations of the Company. Corporate debt is the primary source of corporate interest expense.

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 the Company's 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 are reported in the equity in income 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, 2014.

**Use of Estimates**—Preparing the Company's consolidated financial statements in accordance with GAAP 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 critical 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 \$11.3 billion and \$10.8 billion at March 31, 2015 and December 31, 2014, respectively. Of this amount, \$2.9 billion had been pledged or sold in connection with securities loans, bank borrowings and deposits with clearing organizations at both March 31, 2015 and December 31, 2014.

***Share-Based Payments***—The Company issues restricted stock awards to the Company's Board of Directors and restricted stock units to certain of the Company's officers and employees. Each restricted stock unit can be converted into one share of the Company's common stock upon vesting. These restricted stock awards and units are issued at the fair value on the date of grant and vest ratably over the requisite service period, generally one to four years. Beginning in 2015, the Company also issued performance share units to certain of the Company's officers. Each performance share unit can be converted into one share of the Company's common stock upon vesting. Vesting of performance share units is contingent upon achievement of certain predefined individual and Company performance targets. These performance share units are issued at the fair value on the date of grant and vest on a graded basis over the requisite service period, which is one to two years.

The Company records share-based compensation expense in accordance with the stock compensation accounting guidance. The Company recognizes compensation expense at the grant date fair value of a share-based payment award over the requisite service period less estimated forfeitures. Compensation expense for performance share units is also adjusted based on the Company's estimated outcome of meeting the performance conditions. Share-based compensation expense is included in the compensation and benefits line item.

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

***Accounting for Investments in Qualified Affordable Housing Projects***

In January 2014, the FASB amended the accounting guidance for investments in qualified affordable housing projects. The amended accounting guidance permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax credits and other tax benefits received and the net investment performance is recognized in the consolidated statement of income as a component of income tax expense. The Company adopted the amended accounting guidance for its qualifying investments on a full retrospective basis for annual and interim periods beginning on January 1, 2015. The adoption of the amended guidance did not have a material impact on the Company's financial condition, results of operations or cash flows for the periods presented. For the quarter ended March 31, 2015, \$1 million of amortization and \$1 million of tax credits associated with these investments were recognized within income tax expense in the consolidated statement of income. As of March 31, 2015, the carrying value of these investments was \$34 million and is included within other assets in the consolidated balance sheet.

***Presentation and Disclosure of Discontinued Operations***

In April 2014, the FASB amended the presentation and disclosure guidance on disposal transactions. The amended guidance raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The amended guidance became effective for all disposals or classifications as held for sale occurring in annual and interim periods beginning on January 1, 2015 for the Company. The adoption of the amended guidance did not have a material impact on the Company's financial condition, results of operations or cash flows; however, it may impact the reporting of future disposals if and when they occur.

***Revenue Recognition on Contracts with Customers***

In May 2014, the FASB amended the guidance on revenue recognition on contracts with customers. The new standard outlines a single comprehensive model for entities to apply in accounting for revenue arising from contracts with customers. The amended guidance will be effective for annual and interim periods beginning on January 1, 2017 for the Company and may be applied on either a full retrospective or modified retrospective basis. Early adoption is not permitted. While the Company is currently evaluating the impact of the new accounting guidance, the adoption of the amended guidance is not expected to have a material impact on the Company's financial condition, results of operations or cash flows.

*Accounting and Disclosures for Repurchase Agreements*

In June 2014, the FASB amended the accounting and disclosure guidance on repurchase agreements. The amended guidance requires entities to account for repurchase-to-maturity transactions as secured borrowings, eliminates accounting guidance on linked repurchase financing transactions, and expands the disclosure requirements related to transfers of financial assets accounted for as sales and as secured borrowings. The amended accounting guidance and the amended disclosure guidance for transfers of financial assets accounted for as sales became effective for annual and interim periods beginning on January 1, 2015 for the Company and was applied using a cumulative-effect approach as of that date. The adoption of this amended guidance did not have a material impact on the Company's financial condition, results of operations or cash flows. The amended disclosure guidance for transfers of financial assets accounted for as secured borrowings became effective for annual periods beginning on January 1, 2015 and interim periods beginning on April 1, 2015 for the Company. The Company's disclosures for the quarter ending June 30, 2015 will reflect the adoption of this amended disclosure guidance.

*Classification of Government-Guaranteed Mortgage Loans upon Foreclosure*

In August 2014, the FASB amended the accounting and disclosure guidance related to the classification of certain government-guaranteed mortgage loans upon foreclosure. The amended guidance requires entities to derecognize a mortgage loan and recognize a separate other receivable upon foreclosure if certain conditions are met. The separate other receivable is recorded based on the amount of principal and interest expected to be recovered under the guarantee. The amended guidance became effective for annual and interim periods beginning on January 1, 2015 for the Company and was applied on a modified retrospective basis to qualifying loans at that date. The adoption of the amended guidance did not have a material impact on the Company's financial condition, results of operations or cash flows.

*Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern*

In August 2014, the FASB amended the guidance related to an entity's evaluations and disclosures of going concern uncertainties. The new guidance requires management to perform interim and annual assessments of the entity's ability to continue as a going concern within one year of the date the financial statements are issued, and to provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern. The amended guidance will be effective for the Company for annual periods beginning on January 1, 2016 and for interim periods beginning on January 1, 2017. Early adoption is permitted. The adoption of the amended guidance will not impact the Company's financial condition, results of operations or cash flows.

*Consolidation*

In February 2015, the FASB amended the guidance on consolidation of certain legal entities. The amended guidance modifies the evaluation of whether limited partnerships and similar legal entities are VIEs or voting interest entities, eliminates the presumption that a general partner should consolidate a limited partnership, and clarifies how to determine whether a group of equity holders has power over an entity. The amended guidance will be effective for annual and interim periods beginning on January 1, 2016 for the Company and may be applied on either a full retrospective or modified retrospective basis. While the Company is currently evaluating the impact of the new accounting guidance, the adoption of the amended guidance is not expected to have a material impact on the Company's financial condition, results of operations or cash flows.

*Presentation of Debt Issuance Costs*

In April 2015, the FASB amended the presentation guidance on debt issuance costs. The amended presentation guidance requires that debt issuance costs be presented in an entity's balance sheet as a direct deduction from the related debt liability rather than as an asset. As this guidance is consistent with the Company's historical presentation of debt issuance costs, the Company's adoption of the amended guidance as of January 1, 2015 did not impact the Company's financial condition, results of operations or cash flows.

*Accounting for Customer Fees Paid in a Cloud Computing Arrangement*

In April 2015, the FASB amended the accounting guidance on customer fees paid in a cloud computing arrangement. The amended guidance requires that internal-use software accessed by a customer in a cloud computing arrangement be accounted for as a software license if specific criteria are met; otherwise they should be accounted for as service contracts. The amended guidance will be effective for annual and interim periods beginning on January 1, 2016 for the Company and may be applied on either a full retrospective or prospective basis. While the Company is currently evaluating the impact of the new accounting guidance, the adoption of the amended guidance is not expected to have a material impact on the Company's financial condition, results of operations or cash flows.

**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 millions):

|  | Three Months Ended March |        |
|--|--------------------------|--------|
|  | 31,                      |        |
|  | 2015                     | 2014   |
| Operating interest income:                     |                          |        |
| Loans  | \$ 62                    | \$ 84  |
| Available-for-sale securities                  | 66                       | 79     |
| Held-to-maturity securities                    | 88                       | 77     |
| Margin receivables                             | 68                       | 62     |
| Securities borrowed and other                  | 32                       | 17     |
| Total operating interest income                | 316                      | 319    |
| Operating interest expense:                    |                          |        |
| Securities sold under agreements to repurchase | (26)                     | (35)   |
| FHLB advances and other borrowings             | (15)                     | (17)   |
| Deposits                                       | (2)                      | (2)    |
| Customer payables and other                    | (2)                      | (2)    |
| Total operating interest expense               | (45)                     | (56)   |
| Net operating interest income                  | \$ 271                   | \$ 263 |

**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 the Company 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***

*Residential Mortgage-backed Securities*

The Company's residential mortgage-backed securities portfolio primarily comprised agency mortgage-backed securities and CMOs. Agency mortgage-backed securities and CMOs are guaranteed by U.S. government sponsored enterprises and federal agencies. The weighted average coupon rates for the available-for-sale residential mortgage-backed securities at March 31, 2015 are shown in the following table:

[Table of Contents](#)

|                                   | <b>Weighted Average<br/>Coupon Rate</b> |
|-----------------------------------|---|
| Agency mortgage-backed securities | 3.06%                                   |
| Agency CMOs                       | 3.06%                                   |

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.

*Other Debt Securities*

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.

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. All of the Company's municipal bonds and corporate bonds were rated investment grade at March 31, 2015. 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.

*Publicly Traded Equity Securities*

The fair value measurements of the Company's publicly traded equity securities were classified as Level 1 of the fair value hierarchy as they were based on quoted market prices in active markets.

*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 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.

*Nonrecurring Fair Value Measurement Techniques*

Certain other assets are recorded 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 selling costs has been charged-off; and 2) real estate owned that is carried at the lower of the property's carrying value or fair value less estimated selling costs.

The Company evaluates and reviews assets that have been subject to fair value measurement requirements 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.

[Table of Contents](#)

*Loans Receivable*

Loans that have been delinquent for 180 days or that are in bankruptcy and certain TDR loan modifications are charged-off based on the estimated current value of the underlying property less estimated selling costs. 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, automated valuation models or updated values using 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 reviews additional property valuation data to corroborate or update the valuation.

*Real Estate Owned*

Property valuations for real estate owned 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 valuations included unobservable inputs that were significant to the fair value. 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 at March 31, 2015:

|                     | <b>Unobservable Inputs</b> | <b>Average</b> | <b>Range</b>         |
|---------------------|----------------------------|----------------|----------------------|
| Loans receivable:   |                            |                |                      |
| One- to four-family | Appraised value            | \$ 409,300     | \$4,000-\$910,000    |
| Home equity         | Appraised value            | \$ 248,000     | \$25,000-\$1,232,000 |
| Real estate owned   | Appraised value            | \$ 336,000     | \$25,000-\$925,000   |

**Recurring and Nonrecurring Fair Value Measurements**

Assets and liabilities measured at fair value at March 31, 2015 and December 31, 2014 are summarized in the following tables (dollars in millions):

|  | Level 1 | Level 2   | Level 3 | Total<br>Fair Value |
|--|---------|-----------|---------|---------------------|
| <b>March 31, 2015:</b>   |         |           |         |                     |
| <b>Recurring fair value measurements:</b>                                    |         |           |         |                     |
| <b>Assets</b>  |         |           |         |                     |
| Available-for-sale securities:   |         |           |         |                     |
| Debt securities:   |         |           |         |                     |
| Agency residential mortgage-backed securities and CMOs                       | \$ —    | \$ 12,701 | \$ —    | \$ 12,701           |
| Agency debentures  | —       | 688       | —       | 688                 |
| Agency debt securities   | —       | 379       | —       | 379                 |
| Municipal bonds  | —       | 36        | —       | 36                  |
| Corporate bonds  | —       | 4         | —       | 4                   |
| Total debt securities  | —       | 13,808    | —       | 13,808              |
| Publicly traded equity securities  | 33      | —         | —       | 33                  |
| Total available-for-sale securities  | 33      | 13,808    | —       | 13,841              |
| Other assets:  |         |           |         |                     |
| Derivative assets <sup>(1)</sup>   | —       | 16        | —       | 16                  |
| Total assets measured at fair value on a recurring basis <sup>(2)</sup>      | \$ 33   | \$ 13,824 | \$ —    | \$ 13,857           |
| <b>Liabilities</b>   |         |           |         |                     |
| Derivative liabilities <sup>(1)</sup>  | \$ —    | \$ 113    | \$ —    | \$ 113              |
| Total liabilities measured at fair value on a recurring basis <sup>(2)</sup> | \$ —    | \$ 113    | \$ —    | \$ 113              |
| <b>Nonrecurring fair value measurements:</b>                                 |         |           |         |                     |
| Loans receivable:  |         |           |         |                     |
| One- to four-family  | \$ —    | \$ —      | \$ 19   | \$ 19               |
| Home equity  | —       | —         | 7       | 7                   |
| Total loans receivable   | —       | —         | 26      | 26                  |
| Real estate owned  | —       | —         | 26      | 26                  |
| Total assets measured at fair value on a nonrecurring basis <sup>(3)</sup>   | \$ —    | \$ —      | \$ 52   | \$ 52               |

(1) All derivative assets and liabilities were interest rate contracts at March 31, 2015. Information related to derivative instruments is detailed in Note 7—Accounting for Derivative Instruments and Hedging Activities.

(2) Assets and liabilities measured at fair value on a recurring basis represented 30% and less than 1% of the Company's total assets and total liabilities, respectively, at March 31, 2015.

(3) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet at March 31, 2015, and for which a fair value measurement was recorded during the period.

[Table of Contents](#)

|  | Level 1 | Level 2   | Level 3 | Total Fair Value |
|--|---------|-----------|---------|------------------|
| <b>December 31, 2014:</b>  |         |           |         |                  |
| <b>Recurring fair value measurements:</b>                                    |         |           |         |                  |
| <b>Assets</b>  |         |           |         |                  |
| Available-for-sale securities:   |         |           |         |                  |
| Debt securities:   |         |           |         |                  |
| Agency residential mortgage-backed securities and CMOs                       | \$ —    | \$ 11,164 | \$ —    | \$ 11,164        |
| Agency debentures  | —       | 648       | —       | 648              |
| Agency debt securities   | —       | 499       | —       | 499              |
| Municipal bonds  | —       | 40        | —       | 40               |
| Corporate bonds  | —       | 4         | —       | 4                |
| Total debt securities  | —       | 12,355    | —       | 12,355           |
| Publicly traded equity securities  | 33      | —         | —       | 33               |
| Total available-for-sale securities  | 33      | 12,355    | —       | 12,388           |
| Other assets:  |         |           |         |                  |
| Derivative assets <sup>(1)</sup>   | —       | 24        | —       | 24               |
| Total assets measured at fair value on a recurring basis <sup>(2)</sup>      | \$ 33   | \$ 12,379 | \$ —    | \$ 12,412        |
| <b>Liabilities</b>   |         |           |         |                  |
| Derivative liabilities <sup>(1)</sup>  | \$ —    | \$ 66     | \$ —    | \$ 66            |
| Total liabilities measured at fair value on a recurring basis <sup>(2)</sup> | \$ —    | \$ 66     | \$ —    | \$ 66            |
| <b>Nonrecurring fair value measurements:</b>                                 |         |           |         |                  |
| Loans receivable:  |         |           |         |                  |
| One- to four-family  | \$ —    | \$ —      | \$ 46   | \$ 46            |
| Home equity  | —       | —         | 32      | 32               |
| Total loans receivable   | —       | —         | 78      | 78               |
| Real estate owned  | —       | —         | 38      | 38               |
| Total assets measured at fair value on a nonrecurring basis <sup>(3)</sup>   | \$ —    | \$ —      | \$ 116  | \$ 116           |

- (1) All derivative assets and liabilities were interest rate contracts at December 31, 2014. Information related to derivative instruments is detailed in Note 7—Accounting for Derivative Instruments and Hedging Activities.
- (2) Assets and liabilities measured at fair value on a recurring basis represented 27% and less than 1% of the Company's total assets and total liabilities, respectively, at December 31, 2014.
- (3) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet at December 31, 2014, and for which a fair value measurement was recorded during the period.

The following table presents the gains and losses associated with the assets measured at fair value on a nonrecurring basis during the three months ended March 31, 2015 and 2014 (dollars in millions):

|  | Three Months Ended March 31, |        |
|--|------------------------------|--------|
|  | 2015                         | 2014   |
| One- to four-family  | \$ 2                         | \$ 5   |
| Home equity  | 4                            | 12     |
| Total losses on loans receivable measured at fair value    | \$ 6                         | \$ 17  |
| Losses (gains) on real estate owned measured at fair value | \$ 1                         | \$ (1) |

*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 had no material transfers between Level 1 and 2 during the three months ended March 31, 2015 and 2014.

[Table of Contents](#)

*Recurring Fair Value Measurements Categorized within Level 3*

At both March 31, 2015 and December 31, 2014, no assets or liabilities measured at fair value on a recurring basis were categorized within Level 3 of the fair value hierarchy.

*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, 2015 and December 31, 2014 (dollars in millions):

|   | March 31, 2015    |             |                  |                 |  | Total<br>Fair Value |
|---|-------------------|-------------|------------------|-----------------|--|---------------------|
|   | Carrying<br>Value | Level 1     | Level 2          | Level 3         |  |                     |
| <b>Assets</b>   |                   |             |                  |                 |  |                     |
| Cash and equivalents  | \$ 1,025          | \$ 1,025    | \$ —             | \$ —            |  | \$ 1,025            |
| Cash required to be segregated under federal or other regulations | \$ 849            | \$ 849      | \$ —             | \$ —            |  | \$ 849              |
| Held-to-maturity securities:                                      |                   |             |                  |                 |  |                     |
| Agency mortgage-backed securities and CMOs                        | \$ 9,899          | \$ —        | \$ 10,164        | \$ —            |  | \$ 10,164           |
| Agency debentures   | 171               | —           | 172              | —               |  | 172                 |
| Agency debt securities  | 2,437             | —           | 2,520            | —               |  | 2,520               |
| Other non-agency debt securities                                  | 10                | —           | —                | 10              |  | 10                  |
| Total held-to-maturity securities                                 | <u>\$ 12,517</u>  | <u>\$ —</u> | <u>\$ 12,856</u> | <u>\$ 10</u>    |  | <u>\$ 12,866</u>    |
| Margin receivables  | \$ 8,220          | \$ —        | \$ 8,220         | \$ —            |  | \$ 8,220            |
| Loans receivable, net:  |                   |             |                  |                 |  |                     |
| One- to four-family   | \$ 2,917          | \$ —        | \$ —             | \$ 2,664        |  | \$ 2,664            |
| Home equity   | 2,327             | —           | —                | 2,184           |  | 2,184               |
| Consumer and other  | 420               | —           | —                | 424             |  | 424                 |
| Total loans receivable, net <sup>(1)</sup>                        | <u>\$ 5,664</u>   | <u>\$ —</u> | <u>\$ —</u>      | <u>\$ 5,272</u> |  | <u>\$ 5,272</u>     |
| Investment in FHLB stock  | \$ 86             | \$ —        | \$ —             | \$ 86           |  | \$ 86               |
| Deposits paid for securities borrowed                             | \$ 263            | \$ —        | \$ 263           | \$ —            |  | \$ 263              |
| <b>Liabilities</b>  |                   |             |                  |                 |  |                     |
| Deposits  | \$ 26,272         | \$ —        | \$ 26,272        | \$ —            |  | \$ 26,272           |
| Securities sold under agreements to repurchase                    | \$ 3,668          | \$ —        | \$ 3,675         | \$ —            |  | \$ 3,675            |
| Customer payables   | \$ 6,293          | \$ —        | \$ 6,293         | \$ —            |  | \$ 6,293            |
| FHLB advances and other borrowings                                | \$ 1,304          | \$ —        | \$ 922           | \$ 263          |  | \$ 1,185            |
| Corporate debt  | \$ 1,025          | \$ —        | \$ 1,140         | \$ —            |  | \$ 1,140            |
| Deposits received for securities loaned                           | \$ 1,841          | \$ —        | \$ 1,841         | \$ —            |  | \$ 1,841            |

(1) The carrying value of loans receivable, net includes the allowance for loan losses of \$402 million and loans that are valued at fair value on a nonrecurring basis at March 31, 2015.

|   | December 31, 2014 |             |                  |                 |                  |
|---|-------------------|-------------|------------------|-----------------|------------------|
|   | Carrying Value    | Level 1     | Level 2          | Level 3         | Total Fair Value |
| <b>Assets</b>   |                   |             |                  |                 |                  |
| Cash and equivalents  | \$ 1,783          | \$ 1,783    | \$ —             | \$ —            | \$ 1,783         |
| Cash required to be segregated under federal or other regulations | \$ 555            | \$ 555      | \$ —             | \$ —            | \$ 555           |
| Held-to-maturity securities:                                      |                   |             |                  |                 |                  |
| Agency mortgage-backed securities and CMOs                        | \$ 9,793          | \$ —        | \$ 9,971         | \$ —            | \$ 9,971         |
| Agency debentures   | 164               | —           | 166              | —               | 166              |
| Agency debt securities  | 2,281             | —           | 2,329            | —               | 2,329            |
| Other non-agency debt securities                                  | 10                | —           | —                | 10              | 10               |
| Total held-to-maturity securities                                 | <u>\$ 12,248</u>  | <u>\$ —</u> | <u>\$ 12,466</u> | <u>\$ 10</u>    | <u>\$ 12,476</u> |
| Margin receivables  | \$ 7,675          | \$ —        | \$ 7,675         | \$ —            | \$ 7,675         |
| Loans receivable, net:  |                   |             |                  |                 |                  |
| One- to four-family   | \$ 3,053          | \$ —        | \$ —             | \$ 2,742        | \$ 2,742         |
| Home equity   | 2,475             | —           | —                | 2,274           | 2,274            |
| Consumer and other  | 451               | —           | —                | 449             | 449              |
| Total loans receivable, net <sup>(1)</sup>                        | <u>\$ 5,979</u>   | <u>\$ —</u> | <u>\$ —</u>      | <u>\$ 5,465</u> | <u>\$ 5,465</u>  |
| Investment in FHLB stock  | \$ 88             | \$ —        | \$ —             | \$ 88           | \$ 88            |
| Deposits paid for securities borrowed                             | \$ 474            | \$ —        | \$ 474           | \$ —            | \$ 474           |
| <b>Liabilities</b>  |                   |             |                  |                 |                  |
| Deposits  | \$ 24,890         | \$ —        | \$ 24,890        | \$ —            | \$ 24,890        |
| Securities sold under agreements to repurchase                    | \$ 3,672          | \$ —        | \$ 3,681         | \$ —            | \$ 3,681         |
| Customer payables   | \$ 6,455          | \$ —        | \$ 6,455         | \$ —            | \$ 6,455         |
| FHLB advances and other borrowings                                | \$ 1,299          | \$ —        | \$ 922           | \$ 252          | \$ 1,174         |
| Corporate debt  | \$ 1,366          | \$ —        | \$ 1,491         | \$ —            | \$ 1,491         |
| Deposits received for securities loaned                           | \$ 1,649          | \$ —        | \$ 1,649         | \$ —            | \$ 1,649         |

(1) The carrying value of loans receivable, net includes the allowance for loan losses of \$404 million and loans that are valued at fair value on a nonrecurring basis at December 31, 2014.

The fair value measurement techniques for financial instruments not carried at fair value on the consolidated balance sheet at March 31, 2015 and December 31, 2014 are summarized as follows:

*Cash and equivalents, cash required to be segregated under federal or other regulations, margin receivables, deposits paid for securities borrowed, customer payables and deposits received for securities loaned*—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, agency debt securities, and other non-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. Fair value of other non-agency debt securities is estimated to be carrying value.

*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

## [Table of Contents](#)

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.

*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.

*Corporate debt*—For interest-bearing 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; therefore, as the price of the Company's stock increases relative to the conversion price, the fair value of the convertible debentures increases.

### **NOTE 4—OFFSETTING ASSETS AND LIABILITIES**

For financial statement purposes, the Company does not offset derivative instruments, repurchase agreements or securities borrowing and securities lending transactions. These activities are generally 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. The following table presents information about 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 at March 31, 2015 and December 31, 2014 (dollars in millions):

[Table of Contents](#)

|  | Gross Amounts<br>of Recognized<br>Assets and<br>Liabilities | Gross Amounts<br>Offset in the<br>Consolidated<br>Balance Sheet | Net Amounts<br>Presented in the<br>Consolidated<br>Balance Sheet | Gross Amounts Not Offset in the<br>Consolidated Balance Sheet |   | Net Amount |
|--|---|---|--|---|---|------------|
|  |   |   |  | Financial<br>Instruments                                      | Collateral Received<br>or Pledged<br>(Including Cash) |            |
| <b>March 31, 2015</b>  |   |   |  |   |   |            |
| Assets:  |   |   |  |   |   |            |
| Deposits paid for securities<br>borrowed <sup>(1)(5)</sup>   | \$ 263  | \$ —  | \$ 263   | \$ (143)  | \$ (107)  | \$ 13      |
| Derivative assets <sup>(1)(3)</sup>                          | 14  | —   | 14   | (11)  | (3)   | —          |
| Total  | \$ 277  | \$ —  | \$ 277   | \$ (154)  | \$ (110)  | \$ 13      |
| Liabilities:   |   |   |  |   |   |            |
| Repurchase agreements <sup>(4)</sup>                         | \$ 3,668  | \$ —  | \$ 3,668   | \$ —  | \$ (3,663)  | \$ 5       |
| Deposits received for securities<br>loaned <sup>(2)(6)</sup> | 1,841   | —   | 1,841  | (143)   | (1,568)   | 130        |
| Derivative liabilities <sup>(2)(3)</sup>                     | 52  | —   | 52   | (11)  | (41)  | —          |
| Total  | \$ 5,561  | \$ —  | \$ 5,561   | \$ (154)  | \$ (5,272)  | \$ 135     |
| <b>December 31, 2014</b>                                     |   |   |  |   |   |            |
| Assets:  |   |   |  |   |   |            |
| Deposits paid for securities<br>borrowed <sup>(1)(5)</sup>   | \$ 474  | \$ —  | \$ 474   | \$ (188)  | \$ (267)  | \$ 19      |
| Derivative assets <sup>(1)(3)</sup>                          | 24  | —   | 24   | (15)  | (3)   | 6          |
| Total  | \$ 498  | \$ —  | \$ 498   | \$ (203)  | \$ (270)  | \$ 25      |
| Liabilities:   |   |   |  |   |   |            |
| Repurchase agreements <sup>(4)</sup>                         | \$ 3,672  | \$ —  | \$ 3,672   | \$ —  | \$ (3,671)  | \$ 1       |
| Deposits received for securities<br>loaned <sup>(2)(6)</sup> | 1,649   | —   | 1,649  | (188)   | (1,332)   | 129        |
| Derivative liabilities <sup>(2)(3)</sup>                     | 30  | —   | 30   | (15)  | (15)  | —          |
| Total  | \$ 5,351  | \$ —  | \$ 5,351   | \$ (203)  | \$ (5,018)  | \$ 130     |

(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 \$7 million at both March 31, 2015 and December 31, 2014.

(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, 2015 and December 31, 2014.

(5) Included in the gross amounts of deposits paid for securities borrowed was \$118 million and \$278 million at March 31, 2015 and December 31, 2014, 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 counterparties under the Company's master securities loan agreements.

(6) Included in the gross amounts of deposits received for securities loaned was \$1.2 billion and \$1.1 billion at March 31, 2015 and December 31, 2014, 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 counterparties under the Company's master securities loan agreements.

Certain types of derivatives that the Company trades are subject to derivatives clearing agreements ("cleared derivatives contracts") under the Dodd-Frank Act. These cleared derivatives contracts enable clearing by a derivatives clearing organization through a clearing member. Under the contracts, the clearing member typically has a one-way right to offset all contracts in the event of the Company's default or bankruptcy. As such, the cleared derivatives contracts are not bilateral master netting agreements and do not allow for offsetting. At March 31, 2015 and December 31, 2014, the Company had \$2 million and \$0, respectively, in derivative assets of cleared derivatives contracts and \$61 million and \$36 million, respectively, in derivative liabilities of cleared derivatives contracts.

**NOTE 5—AVAILABLE-FOR-SALE AND HELD-TO-MATURITY SECURITIES**

The amortized cost and fair value of available-for-sale and held-to-maturity securities at March 31, 2015 and December 31, 2014 are shown in the following tables (dollars in millions):

|  | Amortized<br>Cost | Gross<br>Unrealized /<br>Unrecognized<br>Gains | Gross<br>Unrealized /<br>Unrecognized<br>Losses | Fair Value |
|--|-------------------|--|---|------------|
| <b>March 31, 2015:</b>                                 |                   |  |   |            |
| Available-for-sale securities:                         |                   |  |   |            |
| Debt securities:                                       |                   |  |   |            |
| Agency residential mortgage-backed securities and CMOs | \$ 12,618         | \$ 145   | \$ (62)   | \$ 12,701  |
| Agency debentures                                      | 644               | 45   | (1)   | 688        |
| Agency debt securities                                 | 365               | 14   | —   | 379        |
| Municipal bonds  | 36                | 1  | (1)   | 36         |
| Corporate bonds  | 5                 | —  | (1)   | 4          |
| Total debt securities                                  | 13,668            | 205  | (65)  | 13,808     |
| Publicly traded equity securities <sup>(1)</sup>       | 33                | —  | —   | 33         |
| Total available-for-sale securities                    | \$ 13,701         | \$ 205   | \$ (65)   | \$ 13,841  |
| Held-to-maturity securities:                           |                   |  |   |            |
| Agency residential mortgage-backed securities and CMOs | \$ 9,899          | \$ 293   | \$ (28)   | \$ 10,164  |
| Agency debentures                                      | 171               | 1  | —   | 172        |
| Agency debt securities                                 | 2,437             | 83   | —   | 2,520      |
| Other non-agency debt securities                       | 10                | —  | —   | 10         |
| Total held-to-maturity securities                      | \$ 12,517         | \$ 377   | \$ (28)   | \$ 12,866  |
| <b>December 31, 2014:</b>                              |                   |  |   |            |
| Available-for-sale securities:                         |                   |  |   |            |
| Debt securities:                                       |                   |  |   |            |
| Agency residential mortgage-backed securities and CMOs | \$ 11,156         | \$ 113   | \$ (105)  | \$ 11,164  |
| Agency debentures                                      | 620               | 28   | —   | 648        |
| Agency debt securities                                 | 487               | 12   | —   | 499        |
| Municipal bonds  | 40                | 1  | (1)   | 40         |
| Corporate bonds  | 5                 | —  | (1)   | 4          |
| Total debt securities                                  | 12,308            | 154  | (107)   | 12,355     |
| Publicly traded equity securities <sup>(1)</sup>       | 33                | —  | —   | 33         |
| Total available-for-sale securities                    | \$ 12,341         | \$ 154   | \$ (107)  | \$ 12,388  |
| Held-to-maturity securities:                           |                   |  |   |            |
| Agency residential mortgage-backed securities and CMOs | \$ 9,793          | \$ 217   | \$ (39)   | \$ 9,971   |
| Agency debentures                                      | 164               | 2  | —   | 166        |
| Agency debt securities                                 | 2,281             | 54   | (6)   | 2,329      |
| Other non-agency debt securities                       | 10                | —  | —   | 10         |
| Total held-to-maturity securities                      | \$ 12,248         | \$ 273   | \$ (45)   | \$ 12,476  |

(1) Publicly traded equity securities consisted of investments in a mutual fund related to the Community Reinvestment Act.

**Contractual Maturities**

The contractual maturities of all available-for-sale and held-to-maturity debt securities at March 31, 2015 are shown below (dollars in millions):

|  | <u>Amortized Cost</u> | <u>Fair Value</u> |
|--|-----------------------|-------------------|
| Available-for-sale debt securities:      |                       |                   |
| Due within one year                      | \$ 3                  | \$ 3              |
| Due within one to five years             | 9                     | 9                 |
| Due within five to ten years             | 1,280                 | 1,300             |
| Due after ten years                      | 12,376                | 12,496            |
| Total available-for-sale debt securities | <u>\$ 13,668</u>      | <u>\$ 13,808</u>  |
| Held-to-maturity debt securities:        |                       |                   |
| Due within one year                      | \$ 169                | \$ 170            |
| Due within one to five years             | 1,035                 | 1,081             |
| Due within five to ten years             | 2,673                 | 2,781             |
| Due after ten years                      | 8,640                 | 8,834             |
| Total held-to-maturity debt securities   | <u>\$ 12,517</u>      | <u>\$ 12,866</u>  |

The Company pledged \$1.2 billion and \$1.6 billion at March 31, 2015 and December 31, 2014, respectively, of available-for-sale debt securities and \$3.4 billion and \$3.1 billion at March 31, 2015 and December 31, 2014, respectively, of held-to-maturity debt securities as collateral for repurchase agreements, derivatives and other purposes.

**Investments with Unrealized or Unrecognized 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, 2015 and December 31, 2014 (dollars in millions):

|  | Less than 12 Months |                                  | 12 Months or More |                                  | Total           |                                  |
|--|---------------------|----------------------------------|-------------------|----------------------------------|-----------------|----------------------------------|
|  | Fair Value          | Unrealized / Unrecognized Losses | Fair Value        | Unrealized / Unrecognized Losses | Fair Value      | Unrealized / Unrecognized Losses |
| <b>March 31, 2015:</b>                                   |                     |                                  |                   |                                  |                 |                                  |
| Available-for-sale securities:                           |                     |                                  |                   |                                  |                 |                                  |
| Debt securities:   |                     |                                  |                   |                                  |                 |                                  |
| Agency residential mortgage-backed securities and CMOs   | \$ 615              | \$ (3)                           | \$ 4,079          | \$ (59)                          | \$ 4,694        | \$ (62)                          |
| Agency debentures  | 14                  | (1)                              | 9                 | —                                | 23              | (1)                              |
| Municipal bonds  | —                   | —                                | 16                | (1)                              | 16              | (1)                              |
| Corporate bonds  | —                   | —                                | 5                 | (1)                              | 5               | (1)                              |
| Total temporarily impaired available-for-sale securities | <u>\$ 629</u>       | <u>\$ (4)</u>                    | <u>\$ 4,109</u>   | <u>\$ (61)</u>                   | <u>\$ 4,738</u> | <u>\$ (65)</u>                   |
| Held-to-maturity securities:                             |                     |                                  |                   |                                  |                 |                                  |
| Agency residential mortgage-backed securities and CMOs   | \$ 161              | \$ (1)                           | \$ 1,852          | \$ (27)                          | \$ 2,013        | \$ (28)                          |
| Agency debentures  | 8                   | —                                | —                 | —                                | 8               | —                                |
| Agency debt securities                                   | —                   | —                                | 146               | —                                | 146             | —                                |
| Total temporarily impaired held-to-maturity securities   | <u>\$ 169</u>       | <u>\$ (1)</u>                    | <u>\$ 1,998</u>   | <u>\$ (27)</u>                   | <u>\$ 2,167</u> | <u>\$ (28)</u>                   |

**December 31, 2014:**

|  |               |               |                 |                 |                 |                 |
|--|---------------|---------------|-----------------|-----------------|-----------------|-----------------|
| Available-for-sale securities:                           |               |               |                 |                 |                 |                 |
| Debt securities:   |               |               |                 |                 |                 |                 |
| Agency residential mortgage-backed securities and CMOs   | \$ 403        | \$ (1)        | \$ 4,674        | \$ (104)        | \$ 5,077        | \$ (105)        |
| Agency debentures  | —             | —             | 9               | —               | 9               | —               |
| Municipal bonds  | 3             | —             | 16              | (1)             | 19              | (1)             |
| Corporate bonds  | —             | —             | 5               | (1)             | 5               | (1)             |
| Total temporarily impaired available-for-sale securities | <u>\$ 406</u> | <u>\$ (1)</u> | <u>\$ 4,704</u> | <u>\$ (106)</u> | <u>\$ 5,110</u> | <u>\$ (107)</u> |
| Held-to-maturity securities:                             |               |               |                 |                 |                 |                 |
| Agency residential mortgage-backed securities and CMOs   | \$ 45         | \$ —          | \$ 2,289        | \$ (39)         | \$ 2,334        | \$ (39)         |
| Agency debt securities                                   | 110           | (1)           | 560             | (5)             | 670             | (6)             |
| Total temporarily impaired held-to-maturity securities   | <u>\$ 155</u> | <u>\$ (1)</u> | <u>\$ 2,849</u> | <u>\$ (44)</u>  | <u>\$ 3,004</u> | <u>\$ (45)</u>  |

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, 2015 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 an impaired 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.

[Table of Contents](#)

The majority of the unrealized or unrecognized losses on mortgage-backed securities are attributable to changes in interest rates in the market. Agency residential mortgage-backed securities and CMOs, agency debentures and agency debt securities are guaranteed or issued by U.S. government sponsored enterprises 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 debt 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 debt securities in an unrealized or unrecognized loss position at March 31, 2015.

There were no impairment losses recognized in earnings on available-for-sale and held-to-maturity securities during the three months ended March 31, 2015 and 2014.

Included within the Company's securities portfolios are securities that have been written-down to a zero carrying value. The credit loss component of debt securities held by the Company that had a noncredit loss component previously recognized in other comprehensive income was \$152 million at both March 31, 2015 and December 31, 2014. Of this amount, \$123 million relates to 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.

***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, 2015 and 2014 are as follows (dollars in millions):

|  | Three Months Ended March 31, |       |
|--|------------------------------|-------|
|  | 2015                         | 2014  |
| Gains on available-for-sale securities | \$ 10                        | \$ 19 |
| Hedge ineffectiveness                  | (1)                          | (4)   |
| Gains on loans and securities, net     | \$ 9                         | \$ 15 |

**NOTE 6—LOANS RECEIVABLE, NET**

Loans receivable, net at March 31, 2015 and December 31, 2014 are summarized as follows (dollars in millions):

|                             | March 31, 2015 | December 31, 2014 |
|-----------------------------|----------------|-------------------|
| One- to four-family         | \$ 2,927       | \$ 3,060          |
| Home equity                 | 2,681          | 2,834             |
| Consumer and other          | 426            | 455               |
| Total loans receivable      | 6,034          | 6,349             |
| Unamortized premiums, net   | 32             | 34                |
| Allowance for loan losses   | (402)          | (404)             |
| Total loans receivable, net | \$ 5,664       | \$ 5,979          |

At March 31, 2015, the Company pledged \$5.1 billion and \$0.4 billion of loans as collateral to the FHLB and Federal Reserve Bank, respectively. At December 31, 2014, the Company pledged \$5.4 billion and \$0.5 billion of loans as collateral to the FHLB and Federal Reserve Bank, respectively.

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, 2015 and December 31, 2014 (dollars in millions):

|   | Recorded Investment |                   | Allowance for Loan Losses |                   |
|---|---------------------|-------------------|---------------------------|-------------------|
|   | March 31, 2015      | December 31, 2014 | March 31, 2015            | December 31, 2014 |
| Collectively evaluated for impairment:      |                     |                   |                           |                   |
| One- to four-family                         | \$ 2,639            | \$ 2,764          | \$ 20                     | \$ 18             |
| Home equity                                 | 2,462               | 2,625             | 298                       | 310               |
| Consumer and other                          | 431                 | 461               | 11                        | 10                |
| Total collectively evaluated for impairment | 5,532               | 5,850             | 329                       | 338               |
| Individually evaluated for impairment:      |                     |                   |                           |                   |
| One- to four-family                         | 309                 | 316               | 11                        | 9                 |
| Home equity                                 | 225                 | 217               | 62                        | 57                |
| Total individually evaluated for impairment | 534                 | 533               | 73                        | 66                |
| Total                                       | \$ 6,066            | \$ 6,383          | \$ 402                    | \$ 404            |

***Credit Quality and Concentrations of Credit Risk***

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 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.

***Credit Quality***

The following tables show the distribution of the Company's mortgage loan portfolios by credit quality indicator at March 31, 2015 and December 31, 2014 (dollars in millions):

[Table of Contents](#)

| <u>Current LTV/CLTV (1)</u>              | <u>One- to Four-Family</u> |                          | <u>Home Equity</u>    |                          |
|--|----------------------------|--------------------------|-----------------------|--------------------------|
|  | <u>March 31, 2015</u>      | <u>December 31, 2014</u> | <u>March 31, 2015</u> | <u>December 31, 2014</u> |
| <=80%                                    | \$ 1,706                   | \$ 1,757                 | \$ 1,033              | \$ 1,081                 |
| 80%-100%                                 | 765                        | 807                      | 706                   | 755                      |
| 100%-120%                                | 285                        | 311                      | 531                   | 557                      |
| >120%                                    | 171                        | 185                      | 411                   | 441                      |
| Total mortgage loans receivable          | \$ 2,927                   | \$ 3,060                 | \$ 2,681              | \$ 2,834                 |
| Average estimated current LTV/CLTV (2)   | 78%                        | 79%                      | 92%                   | 92%                      |
| Average LTV/CLTV at loan origination (3) | 71%                        | 71%                      | 80%                   | 80%                      |

- (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. For home equity loans in the second lien position, the original balance of the first lien loan at origination date and updated valuations on the property underlying the loan are used to calculate CLTV. 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, home price indices were utilized 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 home equity installment loans and maximum available line for home equity lines of credit.

| <u>Current FICO (1)</u>         | <u>One- to Four-Family</u> |                          | <u>Home Equity</u>    |                          |
|---------------------------------|----------------------------|--------------------------|-----------------------|--------------------------|
|                                 | <u>March 31, 2015</u>      | <u>December 31, 2014</u> | <u>March 31, 2015</u> | <u>December 31, 2014</u> |
| >=720                           | \$ 1,661                   | \$ 1,734                 | \$ 1,394              | \$ 1,487                 |
| 719 - 700                       | 278                        | 296                      | 273                   | 292                      |
| 699 - 680                       | 245                        | 260                      | 231                   | 238                      |
| 679 - 660                       | 181                        | 197                      | 196                   | 203                      |
| 659 - 620                       | 228                        | 237                      | 249                   | 258                      |
| <620                            | 334                        | 336                      | 338                   | 356                      |
| Total mortgage loans receivable | \$ 2,927                   | \$ 3,060                 | \$ 2,681              | \$ 2,834                 |

- (1) FICO scores are updated on a quarterly basis; however, there were approximately \$48 million and \$49 million of one- to four-family loans at March 31, 2015 and December 31, 2014, respectively, and \$4 million of home equity loans for both periods, for which the updated FICO scores were not available. For these loans, the current FICO distribution included the most recent FICO scores where available, otherwise the original FICO score was used.

*Concentrations of Credit Risk*

One- to four-family loans include interest-only loans for a five to ten year period, followed by an amortizing period ranging from 20 to 25 years. At March 31, 2015, 42% of the Company's one- to four-family portfolio was not yet amortizing. However, during the trailing twelve months ended March 31, 2015, approximately 16% of these borrowers made voluntary annual principal payments of at least \$2,500 and slightly over a third of those borrowers made voluntary annual principal payments of at least \$10,000.

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 14% of the home equity portfolio was in the first lien position and the Company holds both the first and second lien positions in less than 1% of the home equity loan portfolio at March 31, 2015. The home equity loan portfolio consists of approximately 19% of home equity installment loans and approximately 81% of home equity lines of credit at March 31, 2015.

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. Approximately 7% of this portfolio will require the borrowers to repay the loan in full at the end of the draw period. At March 31, 2015, 79% of the home equity line of credit portfolio had not converted from the interest-only draw period and had not begun amortizing. However, during the trailing twelve months ended March 31, 2015, approximately 40% of the borrowers made annual principal payments of at least \$500 on their home equity lines of credit and slightly under half of those borrowers reduced their principal balance by at least \$2,500.

The following table outlines when one- to four-family and home equity lines of credit convert to amortizing by percentage of the one- to four-family portfolio and home equity line of credit portfolios, respectively, at March 31, 2015:

[Table of Contents](#)

| <b>Period of Conversion to Amortizing Loan</b> | <b>% of One- to Four-Family Portfolio</b> | <b>% of Home Equity Line of Credit Portfolio</b> |
|--|---|--|
| Already amortizing                             | 58%                                       | 21%  |
| Through December 31, 2015                      | 4%  | 23%  |
| Year ending December 31, 2016                  | 16%                                       | 42%  |
| Year ending December 31, 2017 or later         | 22%                                       | 14%  |

Approximately 38% of the Company's mortgage loans receivable were concentrated in California at both March 31, 2015 and December 31, 2014. No other state had concentrations of mortgage loans that represented 10% or more of the Company's mortgage loans receivable at March 31, 2015 and December 31, 2014.

**Delinquent Loans**

The following table shows total loans receivable by delinquency category at March 31, 2015 and December 31, 2014 (dollars in millions):

|                          | <b>Current</b>  | <b>30-89 Days Delinquent</b> | <b>90-179 Days Delinquent</b> | <b>180+ Days Delinquent</b> | <b>Total</b>    |
|--------------------------|-----------------|------------------------------|-------------------------------|-----------------------------|-----------------|
| <b>March 31, 2015</b>    |                 |                              |                               |                             |                 |
| One- to four-family      | \$ 2,666        | \$ 107                       | \$ 25                         | \$ 129                      | \$ 2,927        |
| Home equity              | 2,535           | 77                           | 27                            | 42                          | 2,681           |
| Consumer and other       | 418             | 7                            | 1                             | —                           | 426             |
| Total loans receivable   | <u>\$ 5,619</u> | <u>\$ 191</u>                | <u>\$ 53</u>                  | <u>\$ 171</u>               | <u>\$ 6,034</u> |
| <b>December 31, 2014</b> |                 |                              |                               |                             |                 |
| One- to four-family      | \$ 2,813        | \$ 88                        | \$ 28                         | \$ 131                      | \$ 3,060        |
| Home equity              | 2,702           | 60                           | 29                            | 43                          | 2,834           |
| Consumer and other       | 447             | 7                            | 1                             | —                           | 455             |
| Total loans receivable   | <u>\$ 5,962</u> | <u>\$ 155</u>                | <u>\$ 58</u>                  | <u>\$ 174</u>               | <u>\$ 6,349</u> |

**Nonperforming Loans**

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 (including loans in bankruptcy) and certain junior liens that have a delinquent senior lien. The following table shows the comparative data for nonperforming loans (dollars in millions):

|                                      | <b>March 31, 2015</b> | <b>December 31, 2014</b> |
|--------------------------------------|-----------------------|--------------------------|
| One- to four-family                  | \$ 292                | \$ 294                   |
| Home equity                          | 175                   | 165                      |
| Consumer and other                   | 1                     | 1                        |
| Total nonperforming loans receivable | <u>\$ 468</u>         | <u>\$ 460</u>            |

**Real Estate Owned and Loans with Formal Foreclosure Proceedings in Process**

At March 31, 2015 and December 31, 2014, the Company held \$32 million and \$36 million, respectively, of real estate owned that were acquired through foreclosure or through a deed in lieu of foreclosure or similar legal agreement. The Company also held \$82 million and \$107 million of loans for which formal foreclosure proceedings were in process at March 31, 2015 and December 31, 2014, 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, 2015 and 2014 (dollars in millions):

|  | Three Months Ended March 31, 2015 |                |                       |        |
|--|-----------------------------------|----------------|-----------------------|--------|
|  | One- to<br>Four-Family            | Home<br>Equity | Consumer<br>and Other | Total  |
| Allowance for loan losses, beginning of period | \$ 27                             | \$ 367         | \$ 10                 | \$ 404 |
| Provision for loan losses                      | 5                                 | (2)            | 2                     | 5      |
| Charge-offs                                    | (1)                               | (10)           | (3)                   | (14)   |
| Recoveries                                     | —                                 | 5              | 2                     | 7      |
| Charge-offs, net                               | (1)                               | (5)            | (1)                   | (7)    |
| Allowance for loan losses, end of period       | \$ 31                             | \$ 360         | \$ 11                 | \$ 402 |

|  | Three Months Ended March 31, 2014 |                |                       |        |
|--|-----------------------------------|----------------|-----------------------|--------|
|  | One- to<br>Four-Family            | Home<br>Equity | Consumer<br>and Other | Total  |
| Allowance for loan losses, beginning of period | \$ 102                            | \$ 326         | \$ 25                 | \$ 453 |
| Provision for loan losses                      | (18)                              | 20             | 2                     | 4      |
| Charge-offs                                    | (43)                              | (24)           | (5)                   | (72)   |
| Recoveries                                     | 11                                | 5              | 2                     | 18     |
| Charge-offs, net                               | (32)                              | (19)           | (3)                   | (54)   |
| Allowance for loan losses, end of period       | \$ 52                             | \$ 327         | \$ 24                 | \$ 403 |

The general allowance for loan losses also included a qualitative component to account for a variety of factors that present additional uncertainty that may not be fully considered in the quantitative loss model but are factors the Company believes may impact the level of credit losses. The total qualitative component was \$35 million and \$37 million at March 31, 2015 and December 31, 2014, respectively.

During the three months ended March 31, 2014, 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 was agreed upon to satisfy in full all pending and future repurchase requests with this specific originator. The Company applied the full amount of a payment of \$11 million for the three months ended March 31, 2014 as a recovery to the allowance for loan losses, resulting in a corresponding reduction to net charge-offs as well as provision for loan losses.

**Impaired Loans—Troubled Debt Restructurings**

TDRs include two categories of loans: (1) loan modifications completed under the Company's programs that involve granting an economic concession to a borrower experiencing financial difficulty, and (2) loans that have been charged off based on the estimated current value of the underlying property less estimated selling costs due to bankruptcy notification.

Delinquency status is the primary measure the Company uses to evaluate the performance of loans modified as TDRs. As mentioned above, the Company classifies 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, including loans in bankruptcy, and certain junior liens that have a delinquent senior lien. The following table shows a summary of the Company's recorded investment in TDRs that were on accrual and nonaccrual status, further disaggregated by delinquency status, in addition to the recorded investment in TDRs at March 31, 2015 and December 31, 2014 (dollars in millions):

[Table of Contents](#)

|                          | Nonaccrual TDRs             |                        |                       |                        |                      | Total Recorded Investment in TDRs <sup>(3)(4)</sup> |
|--------------------------|-----------------------------|------------------------|-----------------------|------------------------|----------------------|---|
|                          | Accrual TDRs <sup>(1)</sup> | Current <sup>(2)</sup> | 30-89 Days Delinquent | 90-179 Days Delinquent | 180+ Days Delinquent |   |
| <b>March 31, 2015</b>    |                             |                        |                       |                        |                      |   |
| One- to four-family      | \$ 113                      | \$ 106                 | \$ 30                 | \$ 10                  | \$ 50                | \$ 309  |
| Home equity              | 120                         | 64                     | 17                    | 6                      | 18                   | 225   |
| Total                    | \$ 233                      | \$ 170                 | \$ 47                 | \$ 16                  | \$ 68                | \$ 534  |
| <b>December 31, 2014</b> |                             |                        |                       |                        |                      |   |
| One- to four-family      | \$ 121                      | \$ 111                 | \$ 24                 | \$ 12                  | \$ 48                | \$ 316  |
| Home equity              | 127                         | 51                     | 14                    | 6                      | 19                   | 217   |
| Total                    | \$ 248                      | \$ 162                 | \$ 38                 | \$ 18                  | \$ 67                | \$ 533  |

- (1) Represents loans modified as TDRs that are current and have made six or more consecutive payments.
- (2) Represents loans modified as TDRs that are current but have not yet made six consecutive payments, bankruptcy loans and certain junior lien TDRs that have a delinquent senior lien.
- (3) The unpaid principal balance in one- to four-family TDRs was \$306 million and \$314 million at March 31, 2015 and December 31, 2014, respectively. For home equity loans, the recorded investment in TDRs represents the unpaid principal balance.
- (4) Total recorded investment in TDRs at March 31, 2015 consisted of \$360 million of loans modified as TDRs and \$174 million of loans that have been charged off due to bankruptcy notification. Total recorded investment in TDRs at December 31, 2014 consisted of \$354 million of loans modified as TDRs and \$179 million of loans that have been charged off due to bankruptcy notification.

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, 2015 and 2014 (dollars in millions):

|                     | Average Recorded Investment  |          | Interest Income Recognized   |       |
|---------------------|------------------------------|----------|------------------------------|-------|
|                     | Three Months Ended March 31, |          | Three Months Ended March 31, |       |
|                     | 2015                         | 2014     | 2015                         | 2014  |
| One- to four-family | \$ 313                       | \$ 1,154 | \$ 2                         | \$ 8  |
| Home equity         | 218                          | 237      | 5                            | 4     |
| Total               | \$ 531                       | \$ 1,391 | \$ 7                         | \$ 12 |

The decrease in the average recorded investments of one- to four-family TDRs comparing the three months ended March 31, 2015 and 2014 was primarily due to the transfer and subsequent sale of \$0.8 billion of one- to four-family loans modified as TDRs during 2014.

Included in the allowance for loan losses was a specific valuation allowance of \$73 million and \$66 million that was established for TDRs at March 31, 2015 and December 31, 2014, respectively. The specific allowance for these individually impaired loans represents the forecasted losses over the estimated remaining life of the loans, including the economic concessions granted to the borrowers. The following table shows detailed information related to the Company's TDRs at March 31, 2015 and December 31, 2014 (dollars in millions):

|  | March 31, 2015              |                              |                        | December 31, 2014           |                              |                        |
|--|-----------------------------|------------------------------|------------------------|-----------------------------|------------------------------|------------------------|
|  | 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                          | \$ 86                       | \$ 11                        | \$ 75                  | \$ 88                       | \$ 9                         | \$ 79                  |
| Home equity                                  | 128                         | 62                           | 66                     | 118                         | 57                           | 61                     |
| Without a recorded allowance: <sup>(1)</sup> |                             |                              |                        |                             |                              |                        |
| One- to four-family                          | \$ 223                      | \$ —                         | \$ 223                 | \$ 228                      | \$ —                         | \$ 228                 |
| Home equity                                  | 97                          | —                            | 97                     | 99                          | —                            | 99                     |
| Total:                                       |                             |                              |                        |                             |                              |                        |
| One- to four-family                          | \$ 309                      | \$ 11                        | \$ 298                 | \$ 316                      | \$ 9                         | \$ 307                 |
| Home equity                                  | 225                         | 62                           | 163                    | 217                         | 57                           | 160                    |

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

**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 in a loan modification typically consist of interest rate reductions, maturity date extensions, principal forgiveness or a combination of these concessions. The Company uses specialized servicers that focus on loan modifications and pursue trial modifications for loans that are more than 180 days delinquent. 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 loans modified as TDRs 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 be presented 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, 2015 and 2014 (dollars in millions):

**Three Months Ended March 31, 2015**

|                     | Interest Rate Reduction |                    |   |  |                      |              | Financial Impact                                      |  |
|---------------------|-------------------------|--------------------|---|--|----------------------|--------------|---|--|
|                     | Number of Loans         | Principal Forgiven | Re-age/<br>Extension/<br>Interest<br>Capitalization | Other with<br>Interest Rate<br>Reduction | Other <sup>(1)</sup> | Total        | Pre-Modification<br>Weighted Average<br>Interest Rate | Post-Modification<br>Weighted Average<br>Interest Rate |
| One- to four-family | 6                       | \$ —               | \$ 1  | \$ —                                     | \$ —                 | \$ 1         | 5.9%  | 2.3%   |
| Home equity         | 243                     | —                  | 1   | 1  | 16                   | 18           | 3.8%  | 4.5%   |
| <b>Total</b>        | <b>249</b>              | <b>\$ —</b>        | <b>\$ 2</b>   | <b>\$ 1</b>                              | <b>\$ 16</b>         | <b>\$ 19</b> |   |  |

**Three Months Ended March 31, 2014**

|                     | Interest Rate Reduction |                    |   |  |             |              | Financial Impact                                      |  |
|---------------------|-------------------------|--------------------|---|--|-------------|--------------|---|--|
|                     | Number of Loans         | Principal Forgiven | Re-age/<br>Extension/<br>Interest<br>Capitalization | Other with<br>Interest Rate<br>Reduction | Other       | Total        | Pre-Modification<br>Weighted Average<br>Interest Rate | Post-Modification<br>Weighted Average<br>Interest Rate |
| One- to four-family | 33                      | \$ 1               | \$ 4  | \$ 2                                     | \$ 4        | \$ 11        | 4.8%  | 2.7%   |
| Home equity         | 46                      | —                  | 2   | 1  | 1           | 4            | 4.3%  | 2.0%   |
| <b>Total</b>        | <b>79</b>               | <b>\$ 1</b>        | <b>\$ 6</b>   | <b>\$ 3</b>                              | <b>\$ 5</b> | <b>\$ 15</b> |   |  |

- (1) Includes TDRs that resulted from a loan modification program offered to a subset of borrowers with home equity lines of credit whose original loan terms provided the borrowers the option to accelerate their date of conversion to amortizing loans. As certain terms of our offer represented economic concessions, such as longer amortization periods than were in the original loan agreements, this program resulted in \$14 million of TDRs during the first quarter of 2015.

[Table of Contents](#)

The Company considers modifications that become 30 days past due to have experienced a payment default. The following table shows the recorded investment in modifications that experienced a payment default within 12 months after the modification for the three months ended March 31, 2015 and 2014 (dollars in millions):

|                                    | Three Months Ended March 31, |                     |                 |                     |
|------------------------------------|------------------------------|---------------------|-----------------|---------------------|
|                                    | 2015                         |                     | 2014            |                     |
|                                    | Number of Loans              | Recorded Investment | Number of Loans | Recorded Investment |
| One- to four-family <sup>(1)</sup> | 2                            | \$ 1                | 18              | \$ 7                |
| Home equity <sup>(2)(3)</sup>      | 40                           | 2                   | 8               | —                   |
| <b>Total</b>                       | <b>42</b>                    | <b>\$ 3</b>         | <b>26</b>       | <b>\$ 7</b>         |

- (1) For the three months ended March 31, 2015 and 2014, \$0 and \$2 million, respectively, of the recorded investment in one- to four-family loans that had a payment default in the trailing 12 months was classified as current.
- (2) For both the three months ended March 31, 2015 and 2014, less than \$1 million of the recorded investment in home equity loans that had a payment default in the trailing 12 months was classified as current.
- (3) The vast majority of these home equity modifications during the three months ended March 31, 2015 experienced servicer transfers during this same period.

**NOTE 7—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 and purchased options, including caps, 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, are used to offset exposure to changes in value of certain fixed-rate assets and liabilities. Each derivative instrument 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, 2015 and December 31, 2014 (dollars in millions):

|  | Notional        | Fair Value           |                          |                    |
|--|-----------------|----------------------|--------------------------|--------------------|
|  |                 | Asset <sup>(1)</sup> | Liability <sup>(2)</sup> | Net <sup>(3)</sup> |
| <b>March 31, 2015</b>  |                 |                      |                          |                    |
| Interest rate contracts:   |                 |                      |                          |                    |
| Cash flow hedges   | \$ 2,000        | \$ 14                | \$ (30)                  | \$ (16)            |
| Fair value hedges  | 1,662           | 2                    | (83)                     | (81)               |
| <b>Total derivatives designated as hedging instruments<sup>(4)</sup></b> | <b>\$ 3,662</b> | <b>\$ 16</b>         | <b>\$ (113)</b>          | <b>\$ (97)</b>     |
| <b>December 31, 2014</b>   |                 |                      |                          |                    |
| Interest rate contracts:   |                 |                      |                          |                    |
| Cash flow hedges   | \$ 2,000        | \$ 23                | \$ (24)                  | \$ (1)             |
| Fair value hedges  | 1,069           | 1                    | (42)                     | (41)               |
| <b>Total derivatives designated as hedging instruments<sup>(4)</sup></b> | <b>\$ 3,069</b> | <b>\$ 24</b>         | <b>\$ (66)</b>           | <b>\$ (42)</b>     |

- (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 at March 31, 2015 and December 31, 2014.

**Cash Flow Hedges**

The effective portion of the changes in fair value of the derivative instruments in a cash flow hedge 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 reclassified from accumulated other comprehensive loss into net operating interest income as a yield adjustment in the same period the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivative instrument in a cash flow hedge, 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.

[Table of Contents](#)

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.

The future issuances of liabilities, including repurchase agreements, are largely dependent on the market demand and liquidity in the wholesale borrowings market. At March 31, 2015, the Company believes the forecasted issuance of all liabilities in cash flow hedge relationships is probable. However, unexpected changes in market conditions in future periods could impact the ability to issue these liabilities. The Company believes the forecasted issuance of liabilities 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, 2015 and 2014 (dollars in millions):

|   | Three Months Ended March 31, |                     |
|---|------------------------------|---------------------|
|   | 2015 <sup>(1)</sup>          | 2014 <sup>(1)</sup> |
| Losses on derivatives recognized in OCI (effective portion), net of tax     | \$ (11)                      | \$ (16)             |
| Losses reclassified from AOCI into earnings (effective portion), net of tax | \$ (16)                      | \$ (21)             |

(1) The Company had cash flow hedge ineffectiveness losses of less than \$1 million for both the three months ended March 31, 2015 and 2014, respectively, which are reflected in the Gains on loans and securities, net line item on the consolidated statement of income.

During the upcoming twelve months, the Company expects to include a pre-tax amount of approximately \$101 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 8 years.

The following table shows the balance in accumulated other comprehensive loss attributable to active and discontinued cash flow hedges at March 31, 2015 and December 31, 2014 (dollars in millions):

|                               | March 31, 2015  | December 31, 2014 |
|-------------------------------|---|-------------------|
|                               | Accumulated other comprehensive loss balance (net of tax) related to: |                   |
| Discontinued cash flow hedges | \$ (213)  | \$ (227)          |
| Active cash flow hedges       | (43)  | (34)              |
| Total cash flow hedges        | <u>\$ (256)</u>   | <u>\$ (261)</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, 2015 and December 31, 2014 (dollars in millions):

|   | March 31, 2015        | December 31, 2014 |
|---|-----------------------|-------------------|
|   | Repurchase agreements | \$ (337)          |
| FHLB advances                                 | (77)                  | (81)              |
| Total balance of cash flow hedges, before tax | (414)                 | (422)             |
| Tax benefit                                   | 158                   | 161               |
| Total balance of cash flow hedges, net of tax | <u>\$ (256)</u>       | <u>\$ (261)</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 the derivative instruments 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

[Table of Contents](#)

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, 2015 and 2014 (dollars in millions):

|   | Three Months Ended March 31, |             |                                      |                    |             |                                      |
|---|------------------------------|-------------|--------------------------------------|--------------------|-------------|--------------------------------------|
|   | 2015                         |             |                                      | 2014               |             |                                      |
|   | Hedging Instrument           | Hedged Item | Hedge Ineffectiveness <sup>(1)</sup> | Hedging Instrument | Hedged Item | Hedge Ineffectiveness <sup>(1)</sup> |
| Agency debentures                         | \$ (21)                      | \$ 20       | \$ (1)                               | \$ (31)            | \$ 27       | \$ (4)                               |
| Agency mortgage-backed securities         | (19)                         | 19          | —                                    | (11)               | 11          | —                                    |
| Total gains (losses) included in earnings | \$ (40)                      | \$ 39       | \$ (1)                               | \$ (42)            | \$ 38       | \$ (4)                               |

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

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

Securities sold under agreements to repurchase, FHLB advances and other borrowings at March 31, 2015 and December 31, 2014 are shown in the following table (dollars in millions):

|   | FHLB Advances and Other Borrowings   |               |        |          | Total | Weighted Average Interest Rate |
|---|--------------------------------------|---------------|--------|----------|-------|--------------------------------|
|   | Repurchase Agreements <sup>(1)</sup> | FHLB Advances | Other  |          |       |                                |
| Due within one year                         | \$ 3,268                             | \$ 270        | \$ —   | \$ 3,538 | 0.35% |                                |
| Due between one and two years               | 400                                  | 250           | —      | 650      | 0.88% |                                |
| Due between two and three years             | —                                    | 400           | —      | 400      | 0.43% |                                |
| Thereafter                                  | —                                    | —             | 428    | 428      | 2.94% |                                |
| Subtotal                                    | 3,668                                | 920           | 428    | 5,016    | 0.65% |                                |
| Fair value hedge adjustments                | —                                    | 18            | —      | 18       |       |                                |
| Deferred costs                              | —                                    | (62)          | —      | (62)     |       |                                |
| Total other borrowings at March 31, 2015    | \$ 3,668                             | \$ 876        | \$ 428 | \$ 4,972 | 0.65% |                                |
| Total other borrowings at December 31, 2014 | \$ 3,672                             | \$ 871        | \$ 428 | \$ 4,971 | 0.64% |                                |

(1) The maximum amount at any month end for repurchase agreements was \$3.8 billion and \$4.9 billion for three months ended March 31, 2015 and the year ended December 31, 2014, respectively.

**NOTE 9—CORPORATE DEBT**

Corporate debt at March 31, 2015 and December 31, 2014 is outlined in the following table (dollars in millions):

|   | Face Value | Discount | Net      |
|---|------------|----------|----------|
| <b>March 31, 2015</b>                           |            |          |          |
| Interest-bearing notes:                         |            |          |          |
| 5 <sup>3</sup> / <sub>8</sub> % Notes, due 2022 | \$ 540     | \$ (6)   | \$ 534   |
| 4 <sup>5</sup> / <sub>8</sub> % Notes, due 2023 | 460        | (6)      | 454      |
| Total interest-bearing notes                    | 1,000      | (12)     | 988      |
| Non-interest-bearing debt:                      |            |          |          |
| 0% Convertible debentures, due 2019             | 37         | —        | 37       |
| Total corporate debt                            | \$ 1,037   | \$ (12)  | \$ 1,025 |
| <b>December 31, 2014</b>                        |            |          |          |
| Interest-bearing notes:                         |            |          |          |
| 6 <sup>3</sup> / <sub>8</sub> % Notes, due 2019 | \$ 800     | \$ (5)   | \$ 795   |
| 5 <sup>3</sup> / <sub>8</sub> % Notes, due 2022 | 540        | (7)      | 533      |
| Total interest-bearing notes                    | 1,340      | (12)     | 1,328    |
| Non-interest-bearing debt:                      |            |          |          |
| 0% Convertible debentures, due 2019             | 38         | —        | 38       |
| Total corporate debt                            | \$ 1,378   | \$ (12)  | \$ 1,366 |

During the first quarter of 2015, the Company issued an aggregate principal amount of \$460 million in 4 <sup>5</sup>/<sub>8</sub>% Notes, due 2023. Interest is payable semi-annually and the notes may be called by the Company beginning March 15, 2018 at a premium, which declines over time. The Company used the net proceeds from the issuance of the 4 <sup>5</sup>/<sub>8</sub>% Notes, along with approximately \$432 million of existing corporate cash to redeem all of the outstanding 6 <sup>3</sup>/<sub>8</sub>% Notes due 2019 including paying the associated redemption premiums of \$68 million, accrued interest and related fees and expenses. This resulted in \$73 million in losses on early extinguishment of debt for the quarter ended March 31, 2015.

The Company also entered into an amendment to the senior secured revolving credit facility to increase commitments thereunder by \$50 million during the first quarter of 2015. There was available capacity for borrowings under the revolving credit facility of \$250 million as of March 31, 2015 and the credit facility expires in November 2017. The Company has the ability to borrow against the credit facility for working capital and general corporate purposes. The credit facility contains certain maintenance covenants, including the requirement for the parent company to maintain unrestricted cash of \$100 million. At March 31, 2015, there was no outstanding balance under this credit facility.

**NOTE 10—ACCUMULATED OTHER COMPREHENSIVE LOSS**

The following tables present after-tax changes in each component of accumulated other comprehensive loss for the three months ended March 31, 2015, and 2014 (dollars in millions):

|  | Available-for-sale<br>Securities | Cash Flow<br>Hedging<br>Instruments | Foreign<br>Currency<br>Translation | Total    |
|--|----------------------------------|-------------------------------------|------------------------------------|----------|
| Beginning balance, December 31, 2014                           | \$ 7                             | \$ (261)                            | \$ 5                               | \$ (249) |
| Other comprehensive income (loss) before reclassifications     | 39                               | (11)                                | —                                  | 28       |
| Amounts reclassified from accumulated other comprehensive loss | (6)                              | 16                                  | —                                  | 10       |
| Net change   | 33                               | 5                                   | —                                  | 38       |
| Ending balance, March 31, 2015                                 | \$ 40                            | \$ (256)                            | \$ 5                               | \$ (211) |

|  | Available-for-sale<br>Securities | Cash Flow<br>Hedging<br>Instruments | Foreign<br>Currency<br>Translation | Total    |
|--|----------------------------------|-------------------------------------|------------------------------------|----------|
| Beginning balance, December 31, 2013                           | \$ (160)                         | \$ (298)                            | \$ 5                               | \$ (453) |
| Other comprehensive income (loss) before reclassifications     | 81                               | (16)                                | —                                  | 65       |
| Amounts reclassified from accumulated other comprehensive loss | (12)                             | 21                                  | —                                  | 9        |
| Net change   | 69                               | 5                                   | —                                  | 74       |
| Ending balance, March 31, 2014                                 | \$ (91)                          | \$ (293)                            | \$ 5                               | \$ (379) |

The following table presents the income statement line items impacted by reclassifications out of accumulated other comprehensive loss for the three months ended March 31, 2015 and 2014 (dollars in millions):

| Accumulated Other Comprehensive Loss<br>Components | Amounts Reclassified from Accumulated Other<br>Comprehensive Loss |         | Affected Line Items in the Consolidated Statement of Income<br>(Loss) |
|--|---|---------|---|
|  | Three Months Ended March 31,                                      |         |   |
|  | 2015  | 2014    |   |
| Available-for-sale securities:                     |   |         |   |
|  | \$ 10   | \$ 19   | Gains on loans and securities, net                                    |
|  | (4)   | (7)     | Tax expense   |
|  | \$ 6  | \$ 12   | Reclassification into earnings, net                                   |
| Cash flow hedging instruments:                     |   |         |   |
|  | \$ (26)   | \$ (35) | Operating interest expense  |
|  | 10  | 14      | Tax expense   |
|  | \$ (16)   | \$ (21) | Reclassification into earnings, net                                   |

**NOTE 11—EARNINGS PER SHARE**

The following table presents a reconciliation of basic and diluted earnings per share (in millions, except share data and per share amounts):

|  | Three Months Ended March 31, |         |
|--|------------------------------|---------|
|  | 2015                         | 2014    |
| <b>Basic:</b>  |                              |         |
| Net income   | \$ 40                        | \$ 97   |
| Basic weighted-average shares outstanding (in thousands)                         | 289,741                      | 288,051 |
| Basic earnings per share   | \$ 0.14                      | \$ 0.34 |
| <b>Diluted:</b>  |                              |         |
| Net income   | \$ 40                        | \$ 97   |
| Basic weighted-average shares outstanding (in thousands)                         | 289,741                      | 288,051 |
| Effect of dilutive securities:   |                              |         |
| Weighted-average convertible debentures (in thousands)                           | 3,640                        | 4,080   |
| Weighted-average options and restricted stock issued to employees (in thousands) | 1,341                        | 1,688   |
| Diluted weighted-average shares outstanding (in thousands)                       | 294,722                      | 293,819 |
| Diluted earnings per share   | \$ 0.14                      | \$ 0.33 |

For the three months ended March 31, 2015 and 2014, the Company excluded 0.2 million and 0.7 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 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 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 <sup>2</sup>/<sub>3</sub>% 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.

[Table of Contents](#)

At March 31, 2015 and December 31, 2014, all of the Company's broker-dealer subsidiaries met minimum net capital requirements. The tables below summarize the minimum excess capital requirements for the Company's broker-dealer subsidiaries at March 31, 2015 and December 31, 2014 (dollars in millions):

|                                      | Required Net<br>Capital | Net Capital | Excess Net<br>Capital |
|--------------------------------------|-------------------------|-------------|-----------------------|
| <b>March 31, 2015:</b>               |                         |             |                       |
| E*TRADE Clearing <sup>(1)</sup>      | \$ 179                  | \$ 811      | \$ 632                |
| E*TRADE Securities <sup>(1)(2)</sup> | —                       | 77          | 77                    |
| Other broker-dealers                 | 1                       | 20          | 19                    |
| Total                                | \$ 180                  | \$ 908      | \$ 728                |
| <b>December 31, 2014:</b>            |                         |             |                       |
| E*TRADE Clearing <sup>(1)</sup>      | \$ 170                  | \$ 795      | \$ 625                |
| E*TRADE Securities <sup>(1)</sup>    | —                       | 459         | 459                   |
| Other broker-dealers                 | 1                       | 19          | 18                    |
| Total                                | \$ 171                  | \$ 1,273    | \$ 1,102              |

(1) Elected to use the Alternative method to compute net capital. The net capital requirement was \$250,000 for E\*TRADE Securities for both periods presented.

(2) E\*TRADE Securities was moved from under E\*TRADE Bank in February 2015 and subsequently paid a dividend of \$434 million to the parent company.

**Banking**

E\*TRADE Financial and E\*TRADE Bank are subject to various regulatory capital requirements administered by federal banking agencies. Beginning on January 1, 2015, both E\*TRADE Financial and E\*TRADE Bank calculate regulatory capital under the Basel III framework using the Standardized Approach, subject to transition provisions. Prior to Basel III becoming effective, the risk-based capital guidelines that applied to E\*TRADE Bank were based upon the 1988 capital accords of the BCBS, a committee of central banks and bank supervisors, as implemented by the U.S. Federal banking agencies, including the OCC, commonly known as Basel I. As a savings and loan holding company, E\*TRADE Financial was not previously subject to specific statutory capital requirements. Under the Basel III framework, the vast majority of the Company's margin receivables qualified for 0% risk-weighting and a larger portion of the Company's deferred tax assets were included in regulatory capital, both having a favorable impact on the Company's current capital ratios. A portion of this benefit was offset as trust preferred securities are phased-out from the parent company's capital. In addition, in the first quarter of 2015, the Company made the one-time permanent election to exclude accumulated other comprehensive income from the calculation of Common Equity Tier 1 capital.

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 Financial and E\*TRADE Bank's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, E\*TRADE Financial and E\*TRADE Bank must meet specific capital guidelines that involve quantitative measures of E\*TRADE Financial's and 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 Financial's and 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 Financial and E\*TRADE Bank to meet minimum Common equity Tier 1 capital, Tier 1 risk-based capital, Total risk-based capital, and Tier 1 leverage ratios. Events beyond management's control, such as deterioration in credit markets, could adversely affect future earnings and E\*TRADE Financial's and E\*TRADE Bank's ability to meet future capital requirements and, in the case of E\*TRADE Bank, their ability to pay dividends to the parent company. E\*TRADE Financial and E\*TRADE Bank were categorized as "well capitalized" under the regulatory framework for prompt corrective action for the periods presented in the table below (dollars in millions):

[Table of Contents](#)

|   | March 31, 2015 <sup>(1)</sup> |       |                                  |       |                | December 31, 2014 <sup>(1)</sup> |       |                                  |       |                |
|---|-------------------------------|-------|----------------------------------|-------|----------------|----------------------------------|-------|----------------------------------|-------|----------------|
|   | Actual                        |       | Well Capitalized Minimum Capital |       | Excess Capital | Actual                           |       | Well Capitalized Minimum Capital |       | Excess Capital |
|   | Amount                        | Ratio | Amount                           | Ratio | Amount         | Amount                           | Ratio | Amount                           | Ratio | Amount         |
| <b>E*TRADE Bank<sup>(2)</sup></b>           |                               |       |                                  |       |                |                                  |       |                                  |       |                |
| Tier 1 leverage                             | \$ 4,277                      | 9.8%  | \$ 2,176                         | 5.0%  | \$ 2,101       | \$ 4,548                         | 10.6% | \$ 2,143                         | 5.0%  | \$ 2,405       |
| Tier 1 risk-based capital                   | \$ 4,277                      | 42.4% | \$ 807                           | 8.0%  | \$ 3,470       | \$ 4,548                         | 25.7% | \$ 1,063                         | 6.0%  | \$ 3,485       |
| Total risk-based capital                    | \$ 4,407                      | 43.7% | \$ 1,008                         | 10.0% | \$ 3,399       | \$ 4,772                         | 26.9% | \$ 1,772                         | 10.0% | \$ 3,000       |
| Common equity Tier 1 capital <sup>(3)</sup> | \$ 4,277                      | 42.4% | \$ 656                           | 6.5%  | \$ 3,621       | N/A                              | N/A   | N/A                              | N/A   | N/A            |

(1) Due to the change in regulatory requirements described above, the March 31, 2015 ratios were calculated under Basel III requirements and the December 31, 2014 ratios were calculated under Basel I requirements.

(2) E\*TRADE Securities was moved from under E\*TRADE Bank in February 2015.

(3) The Basel III rule established Common Equity Tier 1 capital as a new tier of capital.

|                              | March 31, 2015 |       |                                  |       |                |
|------------------------------|----------------|-------|----------------------------------|-------|----------------|
|                              | Actual         |       | Well Capitalized Minimum Capital |       | Excess Capital |
|                              | Amount         | Ratio | Amount                           | Ratio | Amount         |
| <b>E*TRADE Financial:</b>    |                |       |                                  |       |                |
| Tier 1 leverage              | \$ 3,681       | 8.4%  | \$ 2,197                         | 5.0%  | \$ 1,484       |
| Tier 1 risk-based capital    | \$ 3,681       | 35.0% | \$ 841                           | 8.0%  | \$ 2,840       |
| Total risk-based capital     | \$ 4,146       | 39.4% | \$ 1,052                         | 10.0% | \$ 3,094       |
| Common equity Tier 1 capital | \$ 3,681       | 35.0% | \$ 684                           | 6.5%  | \$ 2,997       |

**NOTE 13—COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS**

**Legal Matters**

The Company reviews our lawsuits, regulatory inquiries and other legal proceedings on an ongoing basis and provides disclosure and records loss contingencies in accordance with the loss contingencies accounting guidance. The Company establishes an accrual for losses at management's best estimate when it assesses that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. Once established, the estimated liability is revised based on currently available information when an event occurs requiring an adjustment.

**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 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 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. 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. 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. The testimonial phase of the third trial in this matter concluded on June 12, 2012. By order dated May 28, 2014, the Court determined to conduct a second phase of this bench trial to allow Ajaxo to attempt to prove entitlement to additional

## [Table of Contents](#)

royalties. Hearings in phase two of the trial concluded January 8, 2015. Final written closing statements were submitted March 27, 2015. A decision is expected shortly. The Company will continue to defend itself vigorously.

On May 16, 2011, Droplets Inc., the holder of two patents pertaining to user interface servers, filed a complaint in the U.S. District Court for the Eastern District of Texas against E\*TRADE Financial Corporation, E\*TRADE Securities, E\*TRADE Bank and multiple other unaffiliated financial services firms. Plaintiff contends that the defendants engaged in patent infringement under federal law. Plaintiff seeks unspecified damages and an injunction against future infringements, plus royalties, costs, interest and attorneys' fees. On September 30, 2011, the Company and several co-defendants filed a motion to transfer the case to the Southern District of New York. Venue discovery occurred throughout December 2011. On January 1, 2012, a new judge was assigned to the case. On March 28, 2012, a change of venue was granted and the case was transferred to the United States District Court for the Southern District of New York. The Company filed its answer and counterclaim on June 13, 2012 and plaintiff moved to dismiss the counterclaim. The Court issued its order on claim construction on October 22, 2013, and by order dated January 28, 2014, the Court adopted the defendants' proposed claims construction. On March 25, 2014, the court granted plaintiff leave to amend its complaint to add a newly issued patent, but stayed all litigation pertaining to that patent until a covered business method review could be heard by the Patent and Trademark Appeals Board. The defendants' petitions for covered business method reviews were denied by the Patent and Trademark Appeals Board. The Company's motion for summary judgment on the grounds of non-infringement was granted by the U.S. District Court in a Decision and Order dated March 9, 2015. All remaining claims are stayed pending resolution of issues on Droplet's remaining patents under review by the Patent Trial and Appeal Board. The Company will continue to defend itself vigorously in this matter, both in the District Court and at the U.S. Patent Office.

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, along with numerous other financial institutions, is a named defendant in this case. 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. Under the agreement governing the sale of G1 Execution Services, LLC to Susquehanna, the Company remains responsible for any resulting actions taken against G1 Execution Services, LLC as a result of such investigation. 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 is a named defendant in this case. These cases have been consolidated into a multi-district litigation. The Company's time to answer or otherwise respond to the complaints has been stayed pending further orders of the Court. On September 18, 2013, the Court entered the Fifth Amended Complaint. On September 23, 2013, the Court granted the defendants' motion to dismiss the individual creditors' complaint. The individual creditors filed a notice of appeal. The steering committees for plaintiffs and defendants have submitted a joint plan for the next phase of litigation. The next phase of the action will involve individual motions to dismiss. On April 22, 2014, the Court issued its protocols for dismissal motions for those defendants who were "mere conduits" who facilitated the transactions at issue. The motion to dismiss Count I of the Fifth Amended Complaint for failure to state a cause of action was fully briefed on July 2, 2014, and the parties await decision on that motion. The Company will defend itself vigorously in these matters.

On April 30, 2013, a putative class action was filed by John Scranton, on behalf of himself and a class of persons similarly situated, against E\*TRADE Financial Corporation and E\*TRADE Securities in the Superior Court of California, County of Santa Clara, pursuant to the California procedures for a private Attorney General action. The Complaint alleged that the Company misrepresented through its website that it would always automatically exercise options that were in-the-money by \$0.01 or more on expiration date. Plaintiffs allege violations of the California Unfair Competition Law, the California Consumer Remedies Act, fraud, misrepresentation, negligent misrepresentation and breach of fiduciary duty. The case has been deemed complex within the meaning of the California Rules of Court, and a case management conference was held on September 13, 2013. The Company's demurrer and motion to strike the complaint were granted by order dated December 20, 2013. The Court granted leave to amend the complaint. A second amended complaint was filed on January 31, 2014. On March 11, 2014, the Company moved to strike and for a demurrer to the second amended complaint. On October 20, 2014, the Court sustained the Company's demurrer, dismissing four counts of the second amended complaint with prejudice and two counts without prejudice. The plaintiffs filed a third amended complaint on November 10, 2014. The Company filed a third demurrer and motion to strike on December 12, 2014. By order dated March 18, 2015, the Superior Court entered a final order sustaining

## [Table of Contents](#)

the Company's demurrer on all remaining claims with prejudice. Final judgment was entered in the Company's favor on April 8, 2015. Plaintiff filed a Notice of Appeal April 27, 2015. The Company will continue to defend itself vigorously in this matter.

On April 18, 2014, a putative class action was filed by the City of Providence, Rhode Island against forty-one high frequency trading firms, stock exchanges, market-makers, and other broker-dealers, including the Company, in the U.S. District Court for the Southern District of New York. The Complaint alleges that the high frequency trading firms, certain broker-dealers managing dark pools, and the exchanges manipulated the U.S. Securities markets, and that numerous market-makers and broker-dealers participated in that manipulation by doing business with the high frequency traders. As to the Company, the Complaint alleges violation of Sections 10(b) and 20(a) of the Exchange Act. On May 2, 2014, a similar putative class action was filed by American European Insurance Company against forty-two high frequency trading firms, stock exchanges, market-makers, and other broker-dealers, including the Company, in the U.S. District Court for the Southern District of New York. The action filed by American European Insurance Company made allegations substantially similar to the allegations in the City of Providence complaint. On June 13, 2014, a putative class action was filed by James J. Flynn and Dominic Morelli against twenty-six firms including the Company in the United States District Court for the Southern District of New York. The Flynn Complaint made allegations substantially similar to the allegations in the City of Providence Complaint. The consolidated amended complaint does not identify the Company as a defendant or make any allegations regarding the Company.

On March 26, 2015, a putative class action was filed in the U.S. District Court for the Northern District of California by Ty Rayner, on behalf of himself and all others similarly situated, naming E\*TRADE Financial Corporation and E\*TRADE Securities as defendants. The complaint alleges that E\*TRADE breached a fiduciary duty and unjustly enriched itself in connection with the routing of its customers' orders to various market-makers and exchanges. Plaintiff seeks unspecified damages, declaratory relief, restitution, disgorgement of payments received by the Company, and attorneys' fees. By stipulation, the parties have agreed to extend indefinitely the due date for a response to the claim. The Company will defend itself vigorously in this matter.

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 estimate a range of reasonably possible losses on its remaining outstanding legal proceedings; however, the Company believes any losses, both individually or in the aggregate, 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, futures, foreign currency 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, CFTC, NFA 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 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.

During 2012, the Company completed a review of order handling practices and pricing for order flow between E\*TRADE Securities and G1 Execution Services, LLC. The Company implemented changes to its practices and procedures that were recommended during the review. Banking regulators and federal securities regulators were regularly updated during the course of the review. Subsequently, on July 11, 2013, FINRA notified E\*TRADE Securities and G1 Execution Services, LLC that it was conducting an examination of both firms' order handling practices. On March 19, 2015, the Company received a Wells notice from FINRA's Market Regulation Department relating to the adequacy of E\*TRADE Securities' order-routing disclosures and supervisory process for reviewing execution quality during the period covered by the Company's 2012 internal review (July 2011 - June 2012). The Company continues to cooperate fully with FINRA in this examination. Under the agreement governing the sale of G1 Execution Services, LLC to Susquehanna, the Company remains responsible for any actions taken against G1 Execution Services, LLC arising from the investigation. In the case of the review of both E\*TRADE Securities and G1 Execution Services, LLC such actions could include monetary penalties and cease-and-desist orders, and

## [Table of Contents](#)

could prompt claims by customers. Any of these actions could materially and adversely affect the Company's broker-dealer 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.

### *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.

The Company's equity and cost method investments are generally limited liability investments in partnerships, companies and other similar entities, including tax credit partnerships and community development entities, which are not required to be consolidated. The Company had \$39 million in unfunded commitments with respect to these investments at March 31, 2015.

At March 31, 2015, the Company had approximately \$29 million of certificates of deposit scheduled to mature in less than one year and \$149 million 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, 2015, management estimated that the maximum potential liability under this arrangement, including the current carrying value of the trusts, was equal to approximately \$436 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; and corporate services. Balance sheet management includes the management of asset allocation; loans previously originated by the Company or purchased from third parties; deposits and customer payables; and credit, liquidity and interest rate risk. The balance sheet management segment utilizes deposits and customer payables and compensates the trading and investing segment via a market-based transfer pricing arrangement, which is eliminated in consolidation.

[Table of Contents](#)

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.

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 millions):

|  | Three Months Ended March 31, 2015 |                          |                  |        |
|--|-----------------------------------|--------------------------|------------------|--------|
|  | Trading and Investing             | Balance Sheet Management | Corporate/ Other | Total  |
| Net operating interest income                                | \$ 165                            | \$ 106                   | \$ —             | \$ 271 |
| Total non-interest income                                    | 174                               | 11                       | —                | 185    |
| Total net revenue  | 339                               | 117                      | —                | 456    |
| Provision for loan losses                                    | —                                 | 5                        | —                | 5      |
| Total operating expense                                      | 203                               | 36                       | 61               | 300    |
| Income (loss) before other income (expense) and income taxes | 136                               | 76                       | (61)             | 151    |
| Total other income (expense)                                 | —                                 | —                        | (88)             | (88)   |
| Income (loss) before income taxes                            | \$ 136                            | \$ 76                    | \$ (149)         | \$ 63  |
| Income tax expense   |                                   |                          |                  | 23     |
| Net income   |                                   |                          |                  | \$ 40  |

|  | Three Months Ended March 31, 2014 |                          |                  |        |
|--|-----------------------------------|--------------------------|------------------|--------|
|  | Trading and Investing             | Balance Sheet Management | Corporate/ Other | Total  |
| Net operating interest income                                | \$ 140                            | \$ 123                   | \$ —             | \$ 263 |
| Total non-interest income                                    | 196                               | 16                       | —                | 212    |
| Total net revenue  | 336                               | 139                      | —                | 475    |
| Provision for loan losses                                    | —                                 | 4                        | —                | 4      |
| Total operating expense                                      | 195                               | 41                       | 54               | 290    |
| Income (loss) before other income (expense) and income taxes | 141                               | 94                       | (54)             | 181    |
| Total other income (expense)                                 | —                                 | —                        | (37)             | (37)   |
| Income (loss) before income taxes                            | \$ 141                            | \$ 94                    | \$ (91)          | \$ 144 |
| Income tax expense   |                                   |                          |                  | 47     |
| Net income   |                                   |                          |                  | \$ 97  |

Total other income (expense) included losses on early extinguishment of corporate debt of \$73 million and \$12 million during the three months ended March 31, 2015 and 2014, respectively. For additional information refer to Note 9—Corporate Debt.

*Segment Assets*

|                         | Trading and Investing | Balance Sheet Management | Corporate/ Other <sup>(1)</sup> | Total     |
|-------------------------|-----------------------|--------------------------|---------------------------------|-----------|
| As of March 31, 2015    | \$ 12,122             | \$ 35,018                | \$ (315)                        | \$ 46,825 |
| As of December 31, 2014 | \$ 12,032             | \$ 33,075                | \$ 423                          | \$ 45,530 |

(1) Corporate/Other category includes corporate assets and other elimination adjustments, such as a line of credit between the operating segments, not allocated to the Company's operating segments.

**NOTE 15—SUBSEQUENT EVENT**

In May 2015, the Company effectively settled uncertain tax positions related to the IRS examination of its 2007, 2009 and 2010 federal tax returns. As a result, the Company will recognize approximately \$225 million of income tax benefit in the second quarter of 2015, the vast majority of which will increase our deferred tax assets. During the third quarter of 2009, the Company incurred a loss on the exchange of interest-bearing corporate debt for non-interest-bearing convertible debentures. The uncertain tax positions were primarily related to whether certain components of that loss were considered deductible or non-deductible for tax purposes.

**ITEM 4. CONTROLS AND PROCEDURES**

- (a) Based on an evaluation under the supervision and with the participation of our management, our Chief Executive Officer and our Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 ("Exchange Act"), were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.
- (b) There were no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2015, identified in connection with management's evaluation required by paragraph (d) of Exchange Act Rules 13a-15 and 15d-15, that have 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**

Information in response to this item can be found under the heading "Legal Matters" in Note 13 (Commitments, Contingencies and Other Regulatory Matters) to Part I. Item 1. Consolidated Financial Statements (Unaudited) in this Quarterly Report and is incorporated by reference into this item.

**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, 2014.

**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.

[Table of Contents](#)

**ITEM 6. EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 4.1                       | Third Supplemental Indenture, dated as of March 5, 2015, between E*TRADE Financial Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed on March 5, 2015) |
| 4.2                       | Form of 4.625% Senior Notes due 2023 (included in Exhibit 4.1)   |
| *10.1                     | Amended Form of Performance Share Unit Award Agreement for Amended 2005 Equity Incentive Plan.   |
| *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.



**E\*TRADE FINANCIAL CORPORATION  
AMENDED AND RESTATED  
NOTICE OF GRANT OF PERFORMANCE UNITS**

«FIRST\_NAME» «LAST\_NAME» (the “*Participant*”) has been granted an award of Performance Units (the “*Award*”) pursuant to the E\*Trade Financial Corporation 2005 Equity Incentive Plan (as amended from time to time, the “*Plan*”), each of which represents the right to receive one (1) share of Stock of E\*Trade Financial Corporation (the “*Company*”) in accordance with the terms and conditions of this Notice and the Amended and Restated Performance Units Agreement that is attached to this Notice (the “*Performance Units Agreement*”). Any capitalized term that is used but not defined in this Notice shall have the meaning set forth in the Performance Units Agreement.

**Date of Grant:** «GRANT\_DATE»

**Number of Performance Units:** 2015 Performance Period (“*2015 Performance Units*”):

«SHARES» in respect of the EPS Goals relating to the 2015 Performance Period as determined in accordance with Exhibit A to the Performance Units Agreement.

«SHARES» in respect of the Delivered Projects goals relating to the 2015 Performance Period as determined in accordance with Exhibit A to the Performance Units Agreement.

2016 Performance Period (“*2016 Performance Units*”):

«SHARES» in respect of the EPS Goals relating to the 2016 Performance Period as determined in accordance with Exhibit A to the Performance Units Agreement.

«SHARES» in respect of the Delivered Projects goals relating to the 2016 Performance Period as determined in accordance with Exhibit A to the Performance Units Agreement.

The number of 2015 Performance Units and 2016 Performance Units (together, the “*Performance Units*”) listed above assumes achievement of the applicable Performance Goals at 100% of the respective target levels, and is subject to adjustment as provided in the Performance Units Agreement and the Plan.

**Vesting:** The Performance Units are subject to vesting in accordance with the terms and conditions of the Performance Units Agreement. The actual number of Performance Units that may become vested is subject to the achievement of the applicable Performance Goals and may be lesser or greater than the applicable number of Performance Units listed in this Notice.

**Settlement Dates:** Unless otherwise specified in the Performance Units Agreement, any shares of Stock that become deliverable to the Participant under the terms and conditions of the Performance Units Agreement shall be delivered to the Participant as follows:

2015 Performance Units: As soon as practicable following the Company’s determination of the achievement of the Performance Goals relating to the 2015 Performance Period, but in no event later than March 15, 2016.

2016 Performance Units: As soon as practicable following the Company’s determination of the achievement of the Performance Goals relating to the 2016 Performance Period, but in no event later than March 15, 2017.

The Participant acknowledges that copies of the Plan, Performance Units Agreement and the prospectus for the Plan are available on the Company’s internal web site and may be viewed and printed by the Participant for

---

attachment to the Participant's copy of this Grant Notice. The Participant represents that the Participant has read and is familiar with the provisions of the Plan and Performance Units Agreement, and hereby accepts the Award subject to all of their terms and conditions.

The Participant further acknowledges that this Amended and Restated Notice of Grant of Performance Units supersedes that certain Notice of Grant of Performance Units previously provided to the Participant in respect of the 2015 Performance Units and 2016 Performance Units, which is hereby cancelled and of no further force or effect.

By their signatures below or by electronic acceptance or authentication in a form authorized by the Company, the Company and the Participant agree that the Award is governed by this Notice and by the provisions of the Plan and the Performance Units Agreement, both of which are made a part of this document.

E\*TRADE FINANCIAL CORPORATION      PARTICIPANT

By: \_\_\_\_\_  
Signature

Its: \_\_\_\_\_  
Date

Address: 1271 Avenue of the Americas  
14<sup>th</sup> Floor  
New York, NY 10020-1302

# **E\*TRADE FINANCIAL CORPORATION AMENDED AND RESTATED PERFORMANCE UNITS AGREEMENT**

E\*TRADE Financial Corporation has granted to the Participant named in the *Amended and Restated Notice of Grant of Performance Units* (the “**Grant Notice**”) to which this Amended and Restated Performance Units Agreement (this “**Agreement**”) is attached an Award consisting of Performance Units that are subject to the terms and conditions set forth in the Grant Notice and this Agreement (the “**Performance Units**”). The Performance Units have been granted pursuant to the E\*TRADE Financial Corporation 2005 Equity Incentive Plan (as amended from time to time, the “**Plan**”), the provisions of which are incorporated herein by reference. By signing the Grant Notice, the Participant: (a) acknowledges receipt of and represents that the Participant has read and is familiar with the Grant Notice, this Agreement, the Plan and a prospectus for the Plan (the “**Plan Prospectus**”), (b) accepts the grant of the Performance Units subject to all of the terms and conditions of the Grant Notice, this Agreement and the Plan and (c) agrees to accept as binding, conclusive and final all decisions or interpretations of the Committee upon any questions arising under the Grant Notice, this Agreement or the Plan.

## **1. DEFINITIONS AND CONSTRUCTION.**

1.1 **Definitions.** Unless otherwise defined herein, capitalized terms shall have the meanings assigned to such terms in the Plan.

1.2 **Construction.** Captions and titles contained herein are for convenience only and shall not affect the meaning or interpretation of any provision of this Agreement. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term “or” is not intended to be exclusive, unless the context clearly requires otherwise.

## **2. ADMINISTRATION.**

2.1 **Committee Authority.** All questions of interpretation concerning the Grant Notice and this Agreement shall be determined by the “Committee” (as defined below). All determinations by the Committee shall be final and binding upon all persons having an interest in this Agreement or the Award, including the Participant. Any Officer of a Participating Company shall have the authority to act on behalf of the Company with respect to any matter, right, obligation, or election which is the responsibility of or which is allocated to the Company herein, provided the Officer has apparent authority with respect to such matter, right, obligation, or election.

2.2 **Definition of Committee.** For purposes of this Agreement, the “**Committee**” means the Compensation Committee, the Governance Committee or other committee of the Board duly appointed to administer the Plan and having such powers as shall be specified by the Board; provided that if no committee of the Board has been appointed to

---

administer the Plan, the Board shall exercise all of the powers of the Committee granted herein, and, in any event, the Board may in its discretion exercise any or all of such powers.

### 3. **THE AWARD.**

#### 3.1 **Grant of Performance Units.**

(a) **General Information.** The Performance Units have been granted to the Participant effective as of the Date of Grant set forth in the Grant Notice, and consist of (i) Performance Units relating to Performance Goals in respect of the 2015 Performance Period (the “**2015 Performance Units**”) and (ii) Performance Units relating to Performance Goals in respect of the 2016 Performance Period (the “**2016 Performance Units**”). The Performance Units are subject to all of the terms and conditions of the Grant Notice, the Plan and this Agreement. Except as otherwise specified in this Agreement, each Performance Unit represents a right to receive one (1) share of Stock on the applicable Settlement Date referenced in the Grant Notice (the “**Settlement Date**”).

(b) **2015 Performance Units.** The number of 2015 Performance Units that ultimately become eligible for vesting upon achievement of the relevant Performance Goals in accordance with the applicable subsection of Section 4 of this Agreement (the “**2015 Vesting Eligible Units**”) shall be determined by the Committee in its sole discretion in accordance with the terms and conditions of Exhibit A hereto and the number of 2015 Vesting Eligible Units that actually become vested in accordance with the applicable subsection of Section 4 of this Agreement are referred to in this Agreement as the “**2015 Vested Units**”.

(c) **2016 Performance Units.** The number of 2016 Performance Units that ultimately become eligible for vesting upon achievement of the relevant Performance Goals in accordance with the applicable subsection of Section 4 of this Agreement (the “**2016 Vesting Eligible Units**”) and together with the 2015 Vesting Eligible Units, the “**Vesting Eligible Units**”) shall be determined by the Committee in its sole discretion in accordance with the terms and conditions of Exhibit A hereto and the number of 2016 Vesting Eligible Units that actually become vested in accordance with the applicable subsection of Section 4 of this Agreement are referred to in this Agreement as the “**2016 Vested Units**”.

3.2 **No Monetary Payment Required.** The Participant is not required to make any monetary payment as a condition to receiving the Performance Units or any shares of Stock issued in respect thereof.

3.3 **Dividend Equivalents.** If while the Performance Units are outstanding the Company declares a dividend with respect to the shares of Stock, then on the payment date for such dividend the Participant shall be credited with additional Performance Units equal to (a) the product of (i) the total number of Performance Units held by the Participant and (ii) the per-share dollar amount of such dividend, divided by (b) the Fair Market Value per share of Stock on the payment date of such dividend (the “**Dividend Equivalent Units**”).

#### 4. VESTING AND SETTLEMENT OF PERFORMANCE UNITS.

4.1 **Vesting and Settlement Upon Continued Service.** Except as otherwise set forth in Section 4.2 or Section 4.3, the Performance Units shall become vested and be settled as set forth in this Section 4.1.

(a) 2015 Performance Units. If the Participant remains in continuous Service through the applicable Settlement Date in respect of the 2015 Performance Units, then the Company shall deliver to the Participant, in full satisfaction of the Participant's rights with respect to the 2015 Performance Units, a number of shares of Stock on the applicable Settlement Date equal to the sum of (i) the 2015 Vesting Eligible Units and (ii) the Dividend Equivalent Units credited to the Participant with respect to the 2015 Vesting Eligible Units.

(b) 2016 Performance Units. If the Participant remains in continuous Service through the applicable Settlement Date in respect of the 2016 Performance Units, then the Company shall deliver to the Participant, in full satisfaction of the Participant's rights with respect to the 2016 Performance Units, a number of shares of Stock on the applicable Settlement Date equal to the sum of (i) the 2016 Vesting Eligible Units and (ii) the Dividend Equivalent Units credited to the Participant with respect to the 2016 Vesting Eligible Units.

4.2 **Treatment Upon Certain Terminations of Employment Prior to a Change in Control.** Notwithstanding anything set forth in Section 4.1 to the contrary, the Performance Units shall become vested and be settled upon a termination of the Participant's Service as set forth in this Section 4.2.

(a) Termination as a Result of Death or Disability. If the Participant's Service terminates as a result of either (i) the Participant's death or (ii) the Participant's Disability, in each case that occurs prior to the earlier of (x) the Settlement Date in respect of the 2016 Performance Units and (y) a Change in Control, then the Company shall deliver the following number of shares of Stock to the Participant in full satisfaction of the Award as soon as practicable after the date of such termination, but in no event later than the earliest applicable Settlement Date following the date of such termination:

(i) If such termination occurs on or prior to December 31, 2015, a number of shares of Stock equal to the sum of (1) the product of (A) the total number of shares of Stock that would have been delivered to the Participant in respect of the 2015 Performance Units upon achievement of the applicable Performance Goals at 100% of the respective target levels ("**Target Performance Level**") and (B) a fraction, the numerator of which is the total number of days elapsed between January 1, 2015 and the date of such termination and the denominator of which is 365 and (2) any related Dividend Equivalent Units credited as of the date of such termination.

(ii) If such termination occurs between January 1, 2016 and December 31, 2016 (inclusive), a number of shares of Stock equal to the sum of (1) the number of 2015 Performance Units that the Company determines in good faith would become 2015 Vested Units if the Participant remained in Service through the applicable Settlement Date in

respect of the 2015 Performance Units, if not settled as of the date of such termination, (2) the product of (A) the total number of 2016 Performance Units that would have been delivered to the Participant upon achievement of the Target Performance Level and (B) a fraction, the numerator of which is the total number of days elapsed between January 1, 2016 and the date of such termination and the denominator of which is 365 and (3) any related Dividend Equivalent Units credited as of the date of such termination.

(iii) If such termination occurs between January 1, 2017 and the Settlement Date in respect of the 2016 Performance Units, a number of shares of Stock equal to the sum of (1) the number of 2016 Performance Units that the Company determines in good faith would become 2016 Vested Units if the Participant remained in Service through the applicable Settlement Date in respect of the 2016 Performance Units, if not settled as of the date of such termination and (2) any related Dividend Equivalent Units credited as of the date of such termination.

(b) Termination as a Result of an Involuntary Termination or Retirement. If the Participant's Service terminates as a result of an "Involuntary Termination" (as defined below) or "Retirement" (as defined below), in each case prior to the earlier of the Settlement Date in respect of the 2016 Performance Units and a Change in Control, then the Company shall deliver the following number of shares of Stock to the Participant in full satisfaction of the Award:

(i) If such termination occurs on or prior to December 31, 2015, a number of shares of Stock equal to the sum of (1) the product of the number of 2015 Performance Units that the Company determines in good faith would become 2015 Vested Units if the Participant remained in Service through the applicable Settlement Date in respect of the 2015 Performance Units and a fraction, the numerator of which is the total number of days elapsed between January 1, 2015 and the date of such termination and the denominator of which is 365 and (2) any related Dividend Equivalent Units credited as of the date of such termination, with such delivery to occur on the applicable Settlement Date in respect of the 2015 Performance Units.

(ii) If such termination occurs between January 1, 2016 and December 31, 2016 (inclusive), a number of shares of Stock equal to the sum of (1) the number of 2015 Performance Units that the Company determines in good faith would become 2015 Vested Units if the Participant remained in Service through the applicable Settlement Date in respect of the 2015 Performance Units, if not settled as of the date of such termination, (2) the product of the number of 2016 Performance Units that the Company determines in good faith would become 2016 Vested Units if the Participant remained in Service through the applicable Settlement Date in respect of the 2016 Performance Units and a fraction, the numerator of which is the total number of days elapsed between January 1, 2016 and the date of such termination and the denominator of which is 365 and (3) any related Dividend Equivalent Units credited as of the date of such termination, with such delivery to occur on the applicable Settlement Date in respect of the 2016 Performance Units.

(iii) If such termination occurs between January 1, 2017 and the Settlement Date in respect of the 2016 Performance Units, a number of shares of Stock equal to the sum of (1) the number of 2016 Performance Units that the Company determines in good faith would become 2016 Vested Units if the Participant remained in Service through the applicable Settlement Date in respect of the 2016 Performance Units, if not settled as of the date of such termination and (2) any related Dividend Equivalent Units credited as of the date of such termination, with such delivery to occur on the applicable Settlement Date in respect of the 2016 Performance Units.

(c) Certain Defined Terms. For purposes of this Agreement:

(i) “**Involuntary Termination**” shall mean either of the following events: (x) termination by the Participating Company Group of the Participant’s Service for any reason other than for Cause or (y) the Participant’s voluntary resignation of Service following (A) a reduction in the Participant’s level of compensation (including base salary, fringe benefits and target bonus under any corporate performance based bonus or incentive programs) by more than fifteen percent (15%) or (B) a relocation of the Participant’s place of employment by more than fifty (50) miles, provided and only if such reduction or relocation is effected without the Participant’s express written consent; provided that if such term, or the substantive equivalent, is defined in a contract of employment or service, such definition will take precedence over this definition.

(ii) “**Retirement**” means termination of the Participant’s Service on or after the date on which the Participant becomes “Retirement-Eligible.”

(iii) “**Retirement-Eligible**” means the date on which the Participant has both (x) attained age 60 and (y) accrued at least five years of Service.

**4.3 Treatment Upon and Following a Change in Control.** Notwithstanding anything set forth in Section 4.1 to the contrary, the Performance Units shall be subject to the treatment set forth in this Section 4.3 upon and following a Change in Control.

(a) Effect of a Change in Control. If a Change in Control occurs while the Participant remains in continuous Service and prior to the Settlement Date in respect of the 2016 Performance Units, the Performance Units that are outstanding immediately prior to the Change in Control (the “**CIC Units**”) (i) shall no longer be subject to the applicable Performance Goals and (ii) if the Participant remains in continuous Service through the applicable Settlement Date in respect of the applicable CIC Units, shall be settled on the applicable Settlement Date in a number of shares of Stock equal to the sum of (x) the number of shares of Stock that would have been delivered to the Participant in respect of the applicable CIC Units on the applicable Settlement Date upon achievement of the Target Performance Level and (y) any related Dividend Equivalent Units credited to the Participant with respect to the applicable CIC Units being settled.

(b) Treatment Upon Certain Events Occurring On or Following a Change in Control. Notwithstanding anything set forth in Section 4.3(a) to the contrary, if on or following a Change in Control and prior to the Settlement Date in respect of the 2016 Performance Units, either (i) the Participant's Service terminates as a result of (x) an "Involuntary Termination", (y) the Participant's death or (z) the Participant's Disability or (ii) the Participant is or becomes Retirement-Eligible, then the Company shall deliver to the Participant, within ten (10) days following the date of the applicable event in the case of subsection (i) of this Section 4.3(b) or, in the case of clause (ii) of this Section 4.3(b), on the immediately following Settlement Date and, in each case, in full satisfaction of the Award, the number of shares of Stock that would have been delivered to the Participant in accordance with Section 4.3(a) if the Participant remained in Service through the applicable Settlement Date in respect of the 2016 Performance Units.

#### 4.4 **Treatment Upon Other Types of Terminations.**

(a) Termination for Cause. If the Participant's Service is terminated for Cause prior to the Settlement Date in respect of the 2016 Performance Units, then all of the then-outstanding Performance Units and any related Dividend Equivalent Units shall immediately be forfeited and cancelled without the payment of any consideration to the Participant.

(b) Termination for Any Other Reason. If the Participant's Service terminates prior to the Settlement Date in respect of the 2016 Performance Units for any reason not set forth in Sections 4.2, 4.3 or 4.4(a), then all of the then-outstanding Performance Units and any related Dividend Equivalent Units will be immediately cancelled and forfeited without the payment of any consideration to the Participant unless the Committee determines to provide for the vesting and settlement of all or some of such Performance Units or Dividend Equivalent Units in its sole discretion.

### 5. **CERTAIN RESTRICTIONS.**

5.1 **Beneficial Ownership of Shares; Certificate Registration**. The Participant hereby authorizes the Company, in its sole discretion, to deposit for the benefit of the Participant with any broker with which the Participant has an account relationship of which the Company has notice any or all shares of Stock acquired by the Participant hereunder. Except as provided by the preceding sentence or as otherwise determined by the Company, a certificate for the shares of Stock issued hereunder shall be registered in the name of the Participant, or, if applicable, in the names of the heirs of the Participant.

5.2 **Restrictions on Grant of the Award and Issuance of Shares**. The grant of the Performance Units and issuance of shares of Stock hereunder shall be subject to compliance with all applicable requirements of federal, state or foreign law with respect to such securities. No shares of Stock may be issued hereunder if the issuance of such shares would constitute a violation of any applicable federal, state or foreign securities laws or other law or regulations or the requirements of any stock exchange or market system upon which the Stock may then be listed. The inability of the Company to obtain from any regulatory body having jurisdiction the authority, if any, deemed by the Company's legal counsel to be necessary to the lawful issuance of any shares of Stock hereunder shall relieve the Company of any liability in respect of the failure to issue such shares as to which such requisite authority shall not have been

obtained. As a condition to the issuance of shares of Stock hereunder, the Company may require the Participant to satisfy any qualifications that may be necessary or appropriate, to evidence compliance with any applicable law or regulation and to make any representation or warranty with respect thereto as may be requested by the Company.

5.3 **Fractional Shares.** The Company shall not be required to issue fractional shares of Stock hereunder.

## 6. **TAX WITHHOLDING AND OTHER TAX ISSUES.**

### 6.1 **Tax Withholding.**

(a) **In General.** Regardless of any action the Company and/or the Participating Company employing the Participant (the “**Employer**”) take with respect to any or all income tax (including the U.S. federal, state and local tax and/or non-U.S. tax), social insurance, payroll tax, payment on account or other tax-related withholding (the “**Tax-Related Items**”), the Participant acknowledges that the ultimate liability for all Tax-Related Items legally due by the Participant is and remains the Participant’s responsibility and that the Company and/or the Employer (i) make no representations or undertakings regarding the treatment of any Tax-Related Items in connection with any aspect of the Award, including the grant or vesting of the Performance Units, the subsequent sale of any shares of Stock acquired upon vesting and the receipt of any dividends or Dividend Equivalent Units; and (ii) do not commit to structure the terms of the grant or any aspect of the Award to reduce or eliminate Participant’s liability for Tax-Related Items.

(b) **Withholding Methods.** Prior to the relevant taxable event, the Participant shall pay or make arrangements satisfactory to the Company and/or the Employer to satisfy all withholding and payment on account obligations of the Company and/or the Employer. In this regard, if permissible under local law, the Participant authorizes the Company and/or the Employer, at its discretion, to satisfy the obligations with regard to all Tax-Related Items legally payable by the Participant by one or a combination of the following: (a) withholding from the Participant’s wages or other cash compensation paid to the Participant by the Company and/or the Employer; (b) withholding from the proceeds of the sale of shares of Stock acquired upon vesting of the Award; (c) arranging for the sale of shares of Stock otherwise deliverable to the Participant (on the Participant’s behalf and at the Participant’s direction pursuant to this authorization); or (d) withholding otherwise deliverable shares of Stock, provided that the Company only withholds the amount of shares necessary to satisfy the minimum withholding amount or such other amount as may be necessary to avoid adverse accounting treatment. If the Company satisfies the obligation for Tax-Related Items by withholding a number of shares as described herein, the Participant shall be deemed, for tax purposes only, to have been issued the full number of shares of Stock subject to the Vested Units, notwithstanding that a number of the shares are held back solely for the purpose of paying the Tax-Related Items due as a result of any aspect of the Award.

6.2 **Section 409A.** The intent of the parties is that this Agreement comply with Section 409A of the Code (“**Section 409A**”) to the extent subject thereto, and, accordingly,

to the maximum extent permitted, this Agreement shall be interpreted and be administered to be in compliance therewith. Notwithstanding anything contained herein to the contrary, to the extent required in order to avoid accelerated taxation and/or tax penalties under Section 409A, (i) the Participant shall not be considered to have terminated Service for purposes hereof until the Participant would be considered to have incurred a “separation from service” within the meaning of Section 409A and (ii) if the Participant is a “specified employee” within the meaning of Section 409A, as determined under the Company’s established methodology for determining specified employees, shares of Stock that would otherwise be issued hereunder upon the Participant’s termination of Service shall instead be issued on the first business day after the first to occur of (a) the date that is six months following the Participant’s termination of Service and (b) the date of the Participant’s death. The Company makes no representation that any or all of the payments described in this Agreement will be exempt from or comply with Section 409A and makes no undertaking to preclude Section 409A from applying to any such payment. The Participant shall be solely responsible for the payment of any taxes and penalties incurred under Section 409A.

#### **7. ADJUSTMENTS FOR CHANGES IN CAPITAL STRUCTURE.**

Subject to any required action by the stockholders of the Company, in the event of any change in the Stock effected without receipt of consideration by the Company, whether through merger, consolidation, reorganization, reincorporation, recapitalization, reclassification, stock dividend, stock split, reverse stock split, split-up, split-off, spin-off, combination of shares, exchange of shares, or other change in the capital structure of the Company, or in the event of payment of a dividend or distribution to the stockholders of the Company in a form other than Stock (excepting normal cash dividends) that has a material effect on the Fair Market Value of shares of Stock, the Committee shall make appropriate and proportionate adjustments in the number of outstanding Performance Units and/or the number and kind of shares or other property to be issued in respect of Vested Units and Dividend Equivalent Units, in each case to the extent determined by the Committee to be necessary to prevent dilution or enlargement of the Participant’s rights hereunder. For purposes of the foregoing, conversion of any convertible securities of the Company shall not be treated as “effected without receipt of consideration by the Company.” Such adjustments shall be determined by the Committee, and its determination shall be final, binding and conclusive.

#### **8. RIGHTS AS A STOCKHOLDER OR SERVICE PROVIDER.**

The Participant shall have no rights as a stockholder with respect to any shares of Stock underlying the Performance Units or Dividend Equivalent Units granted hereunder until the date of the issuance of a certificate for such shares (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). No adjustment shall be made for dividends, distributions or other rights for which the record date is prior to the date such certificate is issued, except as provided in Section 3.3 and Section 7. Nothing in this Agreement shall confer upon the Participant any right to continue in Service or interfere in any way with any right of the Company to terminate the Participant’s Service at any time.

9. **ACKNOWLEDGEMENT OF NATURE OF PLAN AND AWARD.** In accepting the grant of the Performance Units, the Participant acknowledges that:

(a) the Plan is established voluntarily by the Company, it is discretionary in nature and it may be modified, amended, suspended or terminated by the Company at any time, unless otherwise provided in the Plan and this Agreement;

(b) the grant of the Performance Units is voluntary and occasional and does not create any contractual or other right to receive future grants of Performance Units or other Awards, or benefits in lieu thereof, even if Performance Units or other Awards have been granted repeatedly in the past;

(c) all decisions with respect to future grants of Performance Units or other Awards, if any, will be at the sole discretion of the Company;

(d) the Participant is voluntarily participating in the Plan;

(e) the Performance Units are an extraordinary item that do not constitute compensation of any kind for Service of any kind rendered to the Company or the Employer, and are outside the scope of the Participant's employment or service contract, if any;

(f) the Performance Units are not part of normal or expected compensation or salary for any purposes, including, but not limited to, calculation of any severance, resignation, termination, redundancy, end of service payments, bonuses, long-service awards, any nonqualified pension or retirement benefits, welfare benefits or similar payments and, except to the extent provided under the written terms of the applicable plan, any qualified pension benefits, and in no event should be considered as compensation for, or relating in any way to, past services for the Company or the Employer;

(g) the future value of the underlying shares of Stock is unknown and cannot be predicted with certainty;

(h) in consideration of the grant of the Performance Units, no claim or entitlement to compensation or damages shall arise from termination of this Agreement or the Performance Units granted hereunder or from any diminution in value of the shares of Stock issued hereunder and the Participant irrevocably releases the Company from any such claim that may arise; if, notwithstanding the foregoing, any such claim is found by a court of competent jurisdiction to have arisen, then, by signing this Agreement, the Participant shall be deemed irrevocably to have waived his or her entitlement to pursue such claim;

(i) the Committee shall have the exclusive discretion to determine when the Participant is no longer rendering Services for purposes of this Agreement and the Plan;

(j) the Company is not providing any tax, legal or financial advice, nor is the Company making any recommendations regarding the Participant's participation in the Plan, or the Participant's acquisition or sale of the underlying shares of Stock; and

(k) the Participant is hereby advised to consult with the Participant's own personal tax, legal and financial advisors regarding the Participant's participation in the Plan before taking any action related to the Plan.

## 10. **MISCELLANEOUS PROVISIONS.**

10.1 **Termination or Amendment.** The Committee may terminate or amend the Plan or this Agreement at any time; provided, however, that no such termination or amendment may adversely affect the Participant's rights under this Agreement without the consent of the Participant unless such termination or amendment is necessary to comply with applicable law or government regulation. No amendment or addition to this Agreement shall be effective unless in writing.

10.2 **Nontransferability of the Award.** Neither this Agreement nor any of the Participant's rights hereunder shall be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution. All rights under or with respect to this Agreement shall be exercisable during the Participant's lifetime only by the Participant or the Participant's guardian or legal representative.

10.3 **Further Instruments.** The parties hereto agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

10.4 **Binding Effect.** This Agreement shall inure to the benefit of the successors and assigns of the Company and, subject to the restrictions on transfer set forth herein, be binding upon the Participant and the Participant's heirs, executors, administrators, successors and assigns.

10.5 **Delivery of Documents and Notices.** Any document relating to participation in the Plan or any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given (except to the extent that this Agreement provides for effectiveness only upon actual receipt of such notice) upon personal delivery, electronic delivery at the e-mail address, if any, provided for the Participant by a Participating Company, or upon deposit in the U.S. Post Office or foreign postal service, by registered or certified mail, or with a nationally recognized overnight courier service, with postage and fees prepaid, addressed to the other party at the address shown below that party's signature to the Grant Notice or at such other address as such party may designate in writing from time to time to the other party.

(a) **Description of Electronic Delivery.** The Plan documents, which may include but do not necessarily include: the Plan, the Grant Notice, this Agreement, the Plan Prospectus, and any reports of the Company provided generally to the Company's stockholders,

may be delivered to the Participant electronically. In addition, the Participant may deliver electronically the Grant Notice to the Company or to such third party involved in administering the Plan as the Company may designate from time to time. Such means of electronic delivery may include but do not necessarily include the delivery of a link to a Company intranet or the internet site of a third party involved in administering the Plan, the delivery of the document via e-mail or such other means of electronic delivery specified by the Company.

(b) **Consent to Electronic Delivery.** The Participant acknowledges that the Participant has read Section 10.5(a) of this Agreement and consents to the electronic delivery of the Plan documents, as described in Section 10.5(a). The Participant acknowledges that he or she may receive from the Company a paper copy of any documents delivered electronically at no cost to the Participant by contacting the Company by telephone or in writing. The Participant further acknowledges that the Participant will be provided with a paper copy of any documents if the attempted electronic delivery of such documents fails. Similarly, the Participant understands that the Participant must provide the Company or any designated third party administrator with a paper copy of any documents if the attempted electronic delivery of such documents fails. The Participant may revoke his or her consent to the electronic delivery of documents described in Section 10.5(a) or may change the e-mail address to which such documents are to be delivered (if the Participant has provided an e-mail address) at any time by notifying the Company of such revoked consent or revised e-mail address by telephone, postal service or e-mail. Finally, the Participant understands that he or she is not required to consent to electronic delivery of documents described in Section 10.5(a).

(c) **Consent to Electronic Participation.** If requested by the Company, the Participant hereby consents to participate in the Plan through an on-line or electronic system established and maintained by the Company or a third party designated by the Company. The Participant understands, however, that he or she is not required to consent to electronic participation as described in this Section.

10.6 **Integrated Agreement.** The Grant Notice, this Agreement and the Plan, together with any other agreement between the Participant and a Participating Company referring to the Award shall constitute the entire understanding and agreement of the Participant and the Participating Company Group with respect to the subject matter contained herein or therein and supersedes any prior agreements, understandings, restrictions, representations, or warranties among the Participant and the Participating Company Group with respect to such subject matter other than those as set forth or provided for herein or therein, including without limitation that certain Notice of Grant of Performance Units and Performance Units Agreement previously provided to the Participant in respect of the 2015 Performance Units and 2016 Performance Units, which are hereby cancelled and of no further force or effect. To the extent contemplated herein or therein, the provisions of the Grant Notice and this Agreement shall survive any release of the Award and shall remain in full force and effect.

10.7 **Applicable Law.** The construction, interpretation and performance of this Agreement, and the transactions under it, shall be governed by and construed in accordance with the laws of the State of New York, without regard to principles of conflict of laws and choice of law rules.

10.8 **Severability.** The provisions of this Agreement are severable and if any one or more provisions are determined to be illegal or otherwise unenforceable, in whole or in part, the remaining provisions shall nevertheless be binding and enforceable.

10.9 **Counterparts.** The Grant Notice may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

[Remainder of Page Left Blank Intentionally]

## Exhibit A

### Vesting of Performance Units

The percentage of 2015 Performance Units and 2016 Performance Units set forth in the Grant Notice that shall become Vesting Eligible Units shall be determined by the Committee in its sole discretion in accordance with the terms of this Exhibit A.

#### 1. 2015 Performance Period.

- (a) EPS Goals. The percentage of the number of 2015 Performance Units listed in the Grant Notice in respect of the EPS Goals for the 2015 Performance Period that shall become 2015 Vesting Eligible Units shall be based on the achievement of EPS Goals determined by the Company and communicated to the Participant as soon as practicable following the date hereof.
- (b) Delivered Projects Goals. The percentage of the number of 2015 Performance Units listed in the Grant Notice in respect of the Delivered Projects goals for the 2015 Performance Period that shall become 2015 Vesting Eligible Units shall be based on the achievement of Delivered Projects Goals determined by the Company and communicated to the Participant as soon as practicable following the date hereof.

#### 2. 2016 Performance Period.

- (a) EPS Goals. The percentage of the number of 2016 Performance Units listed in the Grant Notice in respect of the EPS Goals for the 2016 Performance Period that shall become 2016 Vesting Eligible Units shall be based on the achievement of EPS Goals determined by the Company and communicated to the Participant as soon as practicable following January 1, 2016.
- (b) Delivered Projects Goals. The percentage of the number of 2016 Performance Units listed in the Grant Notice in respect of the Delivered Projects goals for the 2016 Performance Period that shall become 2016 Vesting Eligible Units shall be based on the achievement of Delivered Projects Goals determined by the Company and communicated to the Participant as soon as practicable following January 1, 2016.

#### 4. Defined Terms. For purposes of this Exhibit A, the following terms shall have the respective meanings set forth below:

- (a) “**2015 Performance Period**” means the period beginning on January 1, 2015 and ending on December 31, 2015.
- (b) “**2016 Performance Period**” means the period beginning on January 1, 2016 and ending on December 31, 2016.
- (c) “**Delivered Projects**” means those projects with respect to the 2015 Performance Period or 2016 Performance Period, as applicable, that are communicated to the Participant in accordance with this Exhibit A.
- (d) “**EPS Goals**” means the applicable amounts of the Company’s earnings per share for the 2015 Performance Period or 2016 Performance Period, as applicable, that are communicated to the Participant in accordance with this Exhibit A.

[End of Exhibit A]



**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 6, 2015

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 6, 2015

/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)

