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E*TRADE Financial Corp. (ETFC)

Q4 2018 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: Good evening and thank you for joining E*TRADE's Fourth Quarter 2018 Earnings Conference Call. Joining the call today are Chief Executive Officer, Karl Roessner; Chief Operating Officer, Michael Pizzi; and Chief Financial Officer, Chad Turner.

Today's call may include forward-looking statements, including statements about E*TRADE's future operational and financial performance, financial targets and growth expectations, strategic business initiatives, plans concerning capital deployment and outlook on the broader economic environment, which reflect management's current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially.

During the call, the company will also discuss non-GAAP financial measures. For a reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of E*TRADE Financial, please refer to the company's earnings release furnished on Form 8-K, along with the most recent Form 10-K and 10-Qs and other documents the company has filed with the SEC. All of these documents are also available at about.etrade.com.

Note that the company has not reconciled its forward-looking non-GAAP measures, including non-GAAP adjusted operating margin to the most directly comparable GAAP measures because material items that impact that measure are out of the company's control and cannot be reasonably predicted.

This call will present information as of December 31, 2018 and January 24, 2019. The company disclaims any duty to update forward-looking statements made during the call. This call is being recorded and a replay will be available via phone and webcast later this evening at about.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

With that, I will now turn the call over to Mr. Roessner.

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

Thank you, Ash. Good evening, and thank you for joining us today as we close the books on a very strong year. In 2018, we delivered for our customers, adding new functionality for our active traders, enhancing experiences on both our flagship website and mobile platforms, and building a more comprehensive value proposition for RIAs in our newly launched advisor channel, including through our new referral network.

In tandem, the team delivered rock solid service amid pronounced market volatility. These are the operating environments where our people and our model truly prove their mettle. As we delivered a record year for trading activity, net new accounts, net new assets and customer margin balances, which all contributed to our highest annual revenue and operating margin ever. Accomplishments that served as the backdrop for us to return more than $1 billion to our shareholders via stock buybacks and our first ever quarterly dividend.

In order to best tee up where we're going in 2019, I'll start with a recap of where we've been and what we've accomplished this past year. As noted, our customers were remarkably engaged over the past 12 months, generating a record 282,000 DARTs in 2018 up more than 30% from 2017. Beyond shattering last year's record,
each month of the year was stronger than any month before 2018. For the fourth quarter, we posted DARTs of 296,000 second only to the first quarter of this past year.

In addition, we drove continued growth in derivatives engagement, with overall derivative DARTs increasing 34% versus the year-ago quarter, and the number of accounts trading derivatives growing by 11% over the same period. We expect the derivative mix to continue to improve as we leverage the E*TRADE brand to attract option traders to our Power E*TRADE platform, which continues to expand its roster of intuitive and powerful capabilities.

Accounts and asset growth were also strong in 2018. Excluding acquisitions, we generated $15.2 billion in net new assets, and 204,000 net new brokerage accounts, both company records. We see significant opportunity for growth in 2019 through our exceptional trading offering, our growing investment offerings and access to wealth management solutions, both digital and offline, spanning Core Portfolios, our highly rated robo advisor and our institutional custody platform, E*TRADE Advisor Services, positioning us to increase retention and drive deeper engagement with our existing customers.

While customer margin balances declined from Q3’s record levels they still finished the year strong at $9.6 billion, up 5% from last year. For the full year, the average margin balances of $10.4 billion is up 35% from the full year 2017 average. We also materially expanded our capabilities through the launch of our new E*TRADE Advisor Services channel. The addition of advisory capabilities serves as a critical vehicle for growth and retention as we can provide our retail clients access solutions for complex wealth management services that extend beyond our traditional self-directed offering.

Furthermore, with the purchase of nearly 1 million brokerage accounts from Capital One in November, we now have close to 7 million accounts across self-directed brokerage, advisory, stock plan administration, and banking, representing significant scale across our breadth of offerings. Our substantial customer and asset base means that even modest penetration into our emerging wealth business from our existing customer base provides ample opportunity for growth.

Of particular note in this endeavor is the launch of our E*TRADE Advisor Network, which leverages our distribution channels to link customers desiring an advisor solution, with the most well-suited registered investment advisor. Edelman Financial and Mercer Advisors are charter members of the national program and we are also very excited about bringing on other well-known advisors onto the platform that we are in the process of onboarding.

We’re optimistic that we can expand the share of business our clients conduct with us as well as attract new clients and RIAs to our E*TRADE Advisor Services platform. While it’s early days, the demand from RIAs to participate in the program has been strong and the feedback from the field has been encouraging with six of our branches now in the program and a growing pipeline of referred assets.

On the digital wealth front, we attracted solid flows to our managed products during the year and earned top marks from Barron's in its inaugural ranking of robo-advisors, outclassing some significantly larger incumbents. We also made three more key additions to our offerings. First, we greatly expanded our roster of commission free ETFs and no-load, no-transaction fee mutual funds to more than 250 and 4,400 respectively including the addition of Vanguard. This expansion enables our customers to invest every penny into their future while creating truly diversified long-term portfolios.
Second, we launched pre-built portfolios, our incredibly intuitive service that enables self-directed investors to choose from a bundle of ETF or mutual fund portfolios mapped to risk tolerance, time horizon and investment management style allowing customers to get invested in just a few clicks. And third, we launched thematic investing features providing customers with portfolios of select ETFs that invest in companies and industries aligned with their values and interests. Our newest themes include artificial intelligence, gender diversity and self-driving cars.

Turning to Corporate Services, this was a ground-breaking year in which we enjoyed a more than seven fold increase from 2017s net account additions, during the year, we put a significant amount of time and effort into further solidifying our role as a leader in this space with an unrivaled digital offering and a world class service and support team. Enhancements introduced this year include a revamped planning center that helps participant easily factor stock plan benefits into the context of an overall financial strategy, the addition of a peer tracker tool, enabling participants to monitor their performance awards and benchmark them against similar employers and automated 10b5-1 processing, which streamlines the set-up, maintenance and reporting of trading plans for participants and administrators alike.

We implemented a record shattering $23 billion from new stock plan relationships in 2018, just shy of the $25 billion implemented during the four prior years combined and with a robust $5 billion of pending implementations in the pipeline, we continue to feel great about the growth trajectory of this channel.

Within the context of our enhanced trading, investing and new advisory capabilities, we aim to better engage with stock plan participants who will continue to play a key role in our future growth. Further we spoke earlier about the opportunity from our advisor network, and there is perhaps no more fertile ground for referrals than our Corporate Services channel.

In all, 2018 presents a tremendous opportunity, but what truly stands out to me is how our team executed allowing us to easily surpass historical performance records, while delivering E*TRADE’s strongest financial performance ever. The team’s performance enabled us to generate and return significant capital to our shareholders over the course of the year.

During the fourth quarter alone, we repurchased slightly north of $500 million worth of stock as we opportunistically accelerated repurchase volume amid a depressed valuation, bringing our total buybacks for the year to $1.1 billion. We also declared and paid our first ever quarterly common dividend of $0.14 per share in November, which we believe adds a positive new dimension to our investor value proposition. And so, with an extremely productive year behind us, our strategy will tap into the tremendous growth platform we have installed defined by deep operational knowhow, a robust tech prowess and an unrivaled brand. We aim to once again flex our muscles and deliver on the following.

First, we will maintain our position as the undisputed home for active and derivative traders. We've done much to build our position over the past two years, but we will not rest on past successes. This is a crucial customer set that we will continue to surprise and delight through outstanding service and further enhancements to our best-in-class offerings.

Second, we will expand our holistic digital wealth management offering. As we continue to find new ways to deepen our engagement with customers, we are also focused on new and emerging investors. Expect more from us in this space in 2019 and beyond.
Third, we will capitalize on our B2B channels with leading technology solutions. E*TRADE Corporate Services, where we already lead the industry in market share and in customer satisfaction, and E*TRADE Advisor Services where we are entering the custody space with a leading technology solution, a value brand that RIAs want to be attached to and a vast population of accounts and assets that leading advisers can tap into through our new referral program.

Finally, a note on the management realignment we announced late in the year aimed at positioning the company to achieve these goals. As Chief Operating Officer, Mike Pizzi’s role has expanded beyond finance to include technology and operations. These functions are instrumental to the success of our strategy, and I’m excited to have Mike unify the visions of these organizations with an eye toward continuous process improvement, efficient delivery and a laser focus on execution. Mike has proven time and again that he is the type of leader who can get jobs like these done.

As it relates to the finance organization, we are fortunate to have a deep bench of seasoned professionals and are pleased to tap Chad Turner as our new CFO. Chad has been the man behind much of what investors see and analyze and will now take a prominent role on the main stage. As the former head of FP&A, he has been a key player in the development of our strategic and capital plans and served as the bridge between the business and finance. And I'm very excited for you all to get to know him.

To close out my section, it was yet another busy year for our firm during which we continued to demonstrate our ability to grow our business to the benefit of our shareholders, and 2019 is poised to continue that trend. I look forward to showing you all the team has in store.

With that, I will turn it over to our Chief Operating Officer, Mike Pizzi.

Michael A. Pizzi
Executive Vice President, Chief Operating Officer, E*TRADE Financial Corp.

Thanks, Karl. Before introducing Chad to walk through our financial results, I would like to address three topics; one, our capital deployment during the quarter and beyond; two, our sensitivity to interest rates and our investment portfolio strategy; and three, our progress toward our long-term EPS goal. On capital deployment, as Karl highlighted, we were opportunistic in share repurchases during the quarter retiring 10 million shares or 4% of the outstanding balance. We plan to complete the authorization at a measured pace through 2019 with the caveat that we have the flexibility to manage our balance sheet size and capital position through our sweep deposit program which could enable us to accelerate share repurchases if financially compelling to do so.

As a reminder, our sweep deposit program allows us to move customer deposits to third-party banks in a manner totally seamless to our customers. This program accomplishes two goals; one, it gives us flexibility on our balance sheet size; and two, it expands the level of insurance protection for our customers. The rate we earn on these deposits is closely tied to short-term rates. As short-term rates increase and longer-term rates decrease, it may become more compelling to direct deposits off-balance sheet and accelerate our increased buybacks with the freed up capital from a smaller balance sheet. Our stock valuation is obviously an important component of this calculus as well.

Today, we continue to direct capital to balance sheet growth, but I wanted to highlight the tactical flexibility that exists should the yield curve flatten further or invert or valuation becomes even more compelling. The fourth quarter provided a noticeable shift in the yield curve as it flattened by the greatest amount since 2011. The spread between 10-year treasuries and three-month LIBOR compressed by nearly 80 basis points with short-term rates rising 40 basis points, while long-term rates fell by roughly the same amount.
As you are aware, we structure our investments to match the average duration of our liabilities, which remains around three years to four years. But with the balance sheet exposure across the curve and off-balance sheet income tied to short rates, moves like the ones experienced in Q4 do not impact our earnings profile in a material way.

To better help investors model this dynamic, we included a new table on page 18 of the investor deck summarizing sensitivities to net revenue from movements across the curve. With regard to portfolio strategy, in 2017, our board asked us to review the risk reward trade-off of expanding beyond our agency-only investment mandate. Following an exhaustive review we concluded that it would be prudent to build out the capabilities to make investments in the highest rated most senior classes in the asset-backed market.

Over 2019, we intend to begin making purchases of investment securities that do not carry an agency guarantee with the ability to build up to 4% of our interest-earning assets over the course of the year. This market offers a spectrum of maturity profiles which allows us a broader toolset in managing our interest rate risk leading to a more optimal portfolio structure that we believe will generate excess returns without changing our risk profile.

As for the progress on our long-term EPS goal of greater than $7 by 2023, we are only one quarter in but squarely on track and confident in our ability to deliver on this goal. As we mentioned when we communicated this goal last quarter, our modeled assumptions have been stressed to contemplate a variety of market and industry pressures. So even with the recent flattening of the curve and the removal of any future Fed rate hikes from our forecast, we are not hindered in our ability to achieve our targets.

As for other financial commitments during the fourth quarter, we posted a 48% adjusted operating margin, on track to reach 50% in 2020 and the mid-50s by 2023. We paid nearly $540 million to our shareholders through dividends and buybacks, well above our 80% to 90% pay-out target due to the accelerated repurchase activity, and we generated an adjusted return on equity of 18%, on pace to exceed 20% by 2023.

In summary, we are right on track across each of the objectives we laid out last quarter and continue to see tremendous long-term shareholder value creation with the execution of our plan.

Now, I'll turn the call over to our Chief Financial Officer, Chad Turner, to review our financial results for the quarter.

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

Thanks, Mike. It's a pleasure to speak with you all. For the quarter, we reported net income of $270 million or $1.06 per share on revenues of $735 million, up $98 million from the year ago quarter. Included in the quarter was a $12 million or $0.03 per share benefit for provision for loan losses. As for core results, net interest income increased by $16 million sequentially as our net interest margin expanded by 10 basis points on flat average asset balances.

The key drivers of the improved NIM were a 17 basis point expansion of the gross yield on invested assets offset by a 7 basis point greater cost of funds. Average interest earning assets were $60.1 billion, which included the partial period impact of the November onboarding of $1.6 billion in sweep deposits from the Capital One account acquisition.
This was partially offset by strong customer net buying for the majority of the quarter, which I'll expand on in a moment. Our blended deposit rate rose from 18 basis points to 25 basis points, reflective of our October increase.

While I'd note that we did not amend our advertised rates following the December Fed hike, we continue to monitor the competitive landscape and will adjust cash rates if warranted. We model deposit betas of around 20% on brokerage deposits over the long-term, but the blended deposit rate may exceed that as our premium savings product grows. For Q1 2019, we expect the blended deposit rate, including customer payables, to be around 30 basis points.

Our average reinvestment rate in the securities portfolio remains 300 basis points to 325 basis points, consistent with last quarter. We maintained this range despite the decline in long-term rates, as asset spreads have widened and short-term rates have increased, making shorter maturities more attractive.

For the full-year 2019, we expect to generate a net interest margin of around 320 basis points which assumes customer margin balances hold at their current levels and the Fed funds rate does not increase over the course of the year.

With respect to balance sheet size, the most prominent driver will continue to be customer activity whether via new flows to the firm, proceeds from stock plan transactions or net buying or selling activity across our retail and advisor services accounts.

Q4 represented our eighth consecutive quarter of customer net buying capping off a year in which our customers deployed a record $13.6 billion towards market opportunities. During the quarter, our customers were net buyers of $1.6 billion, despite $1.7 billion of net selling during the last few days of December. This drove our period end cash and equivalents to be roughly $1.7 billion higher than the quarter's average as the late influx was not invested due to timing. As you'd expect, the same dynamic drew down the period end margin balance versus the Q4 average. January to-date customer cash and margin have held fairly steady with year-end balances.

Commission revenue of $123 million was up $14 million year-over-year and $6 million sequentially as DARTs of 296,000 improved 11% from Q3 levels. DARTs have moderated slightly to start 2019 with January to-date tracking down around 5% from Q4 levels. Commission per trade declined to $6.66 in Q4 as equity trade mix expanded, trades from our most active customers increased disproportionately and stock plan trades moderated on seasonal factors and depressed valuation on participant shares.

For 2019, we expect CPT to range from $6.60 to $7 where equity volumes and derivative mix will play a key factor on where we fall within the range. Several seasonal factors particularly surrounding stock plan trades can also lead to quarterly variability in this metrics.

Going forward, we expect levels to stabilize within this range. Our forecasts do not include any reductions to advertise commission rates, but our long-term plan does assume some pressure from preferred pricing on our most valuable accounts. Fees and service charges were flat with the prior quarter, as increased order flow revenue on higher DARTs was offset by a reduction in FX revenue, driven by lower Corporate Services activity.

The average yield on third-party cash, which includes off balance sheet sweeps and money funds was up 5 basis points to 148 basis points. We anticipate earning around 165 basis points on third-party cash in Q1, as we benefit from recent moves in short-term rates. Gains on securities were $11 million and we expect to realize around $10 million per quarter going forward.
Moving to expenses. Non-interest expense was $382 million, slightly up from the prior quarter. This quarter’s adjusted operating margin of 48%, which excludes provision benefit remained relatively flat to the prior quarter. Total marketing expense of $48 million brings our total spend for the year to $200 million in line with our expectations. We believe our full-year marketing investment is appropriate for the current environment and expect to carry it through 2019 with the understanding that we can tactically ramp it up or down based on market conditions.

Compensation and benefits were $152 million down $5 million from last quarter on a slight downtick in head count, as well as seasonal declines in payroll, taxes and vacation accruals. Also worth noting was the reduction in FDIC premiums due to the elimination of the surcharge implemented in 2016. This improved our FDIC line by approximately $4 million leaving Q4 with a good run-rate to model going forward. For the full year, our operating margin was 47% adjusting for provision benefit and losses on early extinguishment of debt. For 2019, we anticipate generating an adjusted operating margin of around 48% which assumes no Fed rate hikes for 2019.

As Mike mentioned, even if the Fed keeps its target rate unchanged over the next five years, we remain confident in achieving a 50% operating margin in 2020 and reaching the mid-50s level by 2023. As for corporate cash, we finished the quarter at $391 million reflecting approximately $380 million in distributions from the bank and broker, less the $0.5 billion we used to repurchase our stock and that $36 million to pay our common dividend. As a reminder, we target holding a minimum of $300 million in corporate cash. Additionally we anticipate receiving $250 million in distributions from the bank and broker in Q1.

Lastly, our effective tax rate in the quarter was 26% which included a benefit from the revaluation of state deferred tax assets. We expect the full year tax rate for 2019 to be around 27% noting that it can vary quarter-to-quarter. In closing, 2018 and Q4 produced strong results including a host of records for E*TRADE and we are keeping our foot firmly on the gas in 2019.

On a personal note, I look forward to speaking with you all in the year ahead. And with that we will open the call for questions.
QUESTION AND ANSWER SECTION

Certainly. [Operator Instructions] Our first question comes from the line of Steven Chubak with Wolfe Research. Your line is open. Please go ahead.

Steven Chubak
Analyst, Wolfe Research LLC

Hi, good evening.

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

Hey, Steven.

Steven Chubak
Analyst, Wolfe Research LLC

So wanted to start things off with a question on the earnings log. When you laid this out last year, you noted there was a clear path to achieving that $7 earnings number both in good and bad equity market types, higher cash levels, weaker equity markets type essentially offsetting pressures from declining margin balances, et cetera. And this quarter was really supposed to be a good limit test for that where in the sub equity market environment. We are supposed to see that uptick in cash levels and really that resiliency didn't show through. We actually saw it a bit more, it appears I would say in their results relative to yours. Was hoping you could speak maybe some of the differences in terms of mix that might have impacted that. And I guess just taking a step back what gives you confidence in that $7 earnings number is still achievable given the absence of that resiliency in the quarter?

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

Thanks, Steven. It's a good question. And we've obviously spent some time taking a look through the results. What we have is, when you look at what actually went on in December even though the last few days had significant, and I do mean significant amounts of net selling and the volatility that took place. We still had an overall quarter of net buying, right. Our fourth quarter of net buying, we had record net buying all year long. So you did see the margin balance come down. So I think we ended at about $9.6 billion and you saw a lot of trading activity, a lot of volatility that took place in the market.

So in terms of what we've always said on the cash balances is there is a period of time before you start to see some of that real growth come in. So what we experienced was a quarter of net buying by our customers and what you need to see and what we fully anticipate and still believe in the model obviously that we will put forth is growth in cash that comes through from whether it be net selling activity, corporate stock plan activity, interest dividends, new cash coming onboard or cash coming out of the marketplace, that's not necessarily a three, four, five week swing for us, but I think what we said is, there's sort of a period during which it will match up. But it's not necessarily within the period that you'll see that catch up.
So we're still fully behind the model and I think the certainty that comes around that if you look at the new walk that we've put in, we've actually taken the two interest rate hikes out of the model without any adjustments to either operating margin or the $7 target. So we think the model will hold up very well and we think that we'll still be in a very good place. So quite happy with the results for the year and quite happy with where we're headed in 2019.

Steven Chubak  
Analyst, Wolfe Research LLC

And Karl, just one follow up for me on some of your near-term margin goals. I believe the operating margin target that you've outlined 50% by 2020, it does contemplate some level of revenue growth. Just given some of the macro risks hiding late-cycle fears that we're seeing, has the revenue environment weakened? How should we think about the expense flexibility you guys can demonstrate in a more challenging environment and are you confident that you could still meet your margin targets even if the revenue environment is flattish and maybe even declining a little bit as the rate outlook weakens and may be the cash growth is little bit more muted than you might have anticipated?

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

Sure. So, I don't think the cash growth will be little bit more muted, but I do understand the question is coming through. So, what I would say is, we are extremely confident, right. You never want to say prior performance is an indication of future results. But I think what you have here is a management team and a company that is extremely disciplined around expenses and if we see that there is a dislocation or that there is challenging fronts on the revenue side, we will absolutely tighten the belt and throttle back where we need to and make the cuts that we need to. A lot of what we're doing and a lot of what we've done with Mike Pizzi's role around technology and operations and what we're looking at on the business. He's driving efficiency through the implementation of technology, right and operational excellence.

So that is something that we're absolutely honed in on and laser-focused on. And we think that that will raise great benefits for us going forward, particularly as we bring our advisory network online. As we bring more and more challenging pressures into our call centers, into our operations capability, I think we're in a very good spot Steven. So we're absolutely focused on it and stand behind the operating margin and that's something that we're not going to walk back absent some extreme events.

Steven Chubak  
Analyst, Wolfe Research LLC

Okay. And just one final one for me on yield and maybe the NIM outlook. You spoke of increasing your exposure at asset backed securities. In the current environment, I would say that there is significant investor sensitivity to banks adding credit risk in their securities portfolios even if it's AAA, AA rated CLO securities for example. How much of a yield pick-up do you anticipate from remixing that 4% of earning assets. And how do you get comfortable with that 4% level. And the last thing I just wanted to tack on is on the margin balance side does the guidance of 320 basis points contemplate our end of period margin balances or is that average for the quarter?

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

So the only -- I'm going to ask Mike Pizzi to take sort of the technical piece on where we are from looking at these types of securities. What I would say is, as Mike said in his prepared remarks, and we started looking at this back in 2017. And as I think you'll know Steven and what I think we've shown a Street time and again that we are
extremely disciplined in terms of using our shareholders capital. We’re deploying that capital, in any way that does not drive value for our shareholders in the end run. So I think with that I’ll ask Mike to add some color around what we’re thinking about, what we’re doing, potential impacts and then the remainder of your question?

Michael A. Pizzi
Executive Vice President, Chief Operating Officer, E*TRADE Financial Corp.

So Steven, we’ve spent a quite a bit of time over 2018 studying the market, building out extensive capabilities to model and stress various security types. We looked extensively at sort of various shock scenarios that would be similar to the Federal Reserves’ severe adverse scenario on the types of securities. And we’ve put together a high degree of exacting standards that we believe, that what we would be targeting has no potential really for credit losses under the most serious of scenarios.

Why do we want to do this? When we think about a portfolio that’s sort of mandated in only the agency market, you’re really confining yourself to security types that all exhibits some degree or other negative convexity or high duration under a flattening curve with the ability to add, various type of positively conduct securities at various maturities gives us the ability to construct a portfolio that is just entirely more optimal without really taking any additional dimension of risk.

You specifically mentioned CLOs in your question, those are not really in the types of securities that we’re looking at. We’re really looking at very high quality credit card issuers, the highest quality prime auto issuers, and the best possible commercial mortgage backs that have very, very high degree of enhancements and perform extremely well under the most severe shocks. When we look at this, we don’t see this as a material extension of credit risk in the portfolio and it gives us significant degrees of freedom in terms of portfolio of construction and management of our interest rate risk.

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

And as for your question on margins, Steven this is Chand, consistent with how we’ve guided in prior calls, we just hold margin constant to give you that NIM outlook of 320.

Operator: Our next question comes from the line from Rich Repetto with Sandler O’Neill. Your line is open. Please go ahead.

Richard Henry Repetto
Analyst, Sandler O’Neill & Partners LP

Yeah. Good evening, guys.

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

Hi Rich.

Richard Henry Repetto
Analyst, Sandler O’Neill & Partners LP

Good evening, Karl. My question is on with the backdrop of the $7 in 2023 and I’m assuming that takes significant balance sheet growth to get there. So anyway the first part of the question is, on capital with Tier 1 at 6.6% at the parent, I guess how we’re going to grow the balance sheet without – in the prepared remarks you talked about, I
thought pretty much maintaining the buyback, but I'm just trying to understand where is this capital going to come to fund a significant buyback and less of cut back and the balance sheet growth, if I have it right, that gets you to on that path to $7.23?

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

Yeah, Rich. It's a similar dynamic to past periods in the buyback where we've got sort of essentially the earnings power of both the bank and the broker dealer that are put there essentially generating dividends up to the parent that free cash flow is used from that earnings stream to fund the buyback program. What you see in this quarter is really just an acceleration of the prior buybacks with the $500 million that we completed driving the ratio down a little bit but the earnings power was clearly there to continue the buyback program at a measured pace over 2019 and still leave enough capital in the bank to allow for balance sheet growth to drive towards the $7.

Richard Henry Repetto  
Analyst, Sandler O'Neill & Partners LP

Okay. So the buyback will moderate from this level, the level in the prior quarter – same quarter?

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

The $500 million in a single quarter is over the earnings in the quarter, so we can't continue. We would drop precipitously capital. So we will slow it down now and continue it at a more measured pace to complete the authorization over 2019.

Richard Henry Repetto  
Analyst, Sandler O'Neill & Partners LP

Okay. So my follow-up would be on the corporate stock plan business, a great business for you all. And I know that it's a good – a big driver of the $7 and getting the cash to get there. So in this past quarter, I think it was a unique quarter but we did see if we're doing our math right 20% drop in the corporate stock plan assets. So I guess, can you talk about the cash contribution that you get from it? I guess we're going to assume that this is technology companies and the balances are going to be pretty volatile depending on the market conditions. I think that's what happened this quarter. But anyway the question is, how much cash did the corporate stock plan business actually contribute?

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

So Rich, you're exactly right, right. We are absolutely in a big way in technology and in healthcare. Those are extremely volatile markets and extremely volatile places to be. So we did see a precipitous drop in the number of assets that the Corporate Services plans hold. Right, if their stock came down, that's what we see. It doesn't necessarily impact the flow of dividends or other sort of cash coming through those accounts. What it did do was slow down the sales by stock plan participants because they're not going to sell at those depressed levels if they don't have to, right. So that's what we've seen in terms of the dynamic of stock plan this past quarter. That also had an impact on CPT when you read it through and see how that piece came down. When you lose that additional upside from some of the stock plan trades that has another drag down on CPT. So lot of different factors. Mike or Chad, I don't know if you guys want to add in on anything on the cash side.
Chad E. Turner  
Chief Financial Officer, E*TRADE Financial Corp.

Yeah. On the cash side, cash was relatively flat quarter-over-quarter as I mentioned in the prepared remarks. I'd say their contribution was relatively consistent as far as the percent of the total is what it's been. It didn't have really any impacts on the quarter. So it's consistent with what we talked about last quarter.

Richard Henry Repetto  
Analyst, Sandler O'Neill & Partners LP

Okay.

Operator: Our next question comes from the line of Dan Fannon with Jefferies. Your line is open. Please go ahead.

Daniel Thomas Fannon  
Analyst, Jefferies LLC

Thanks. I guess a bit more short-term, but I guess the comments around January and margin balances kind of staying flat. I guess, can you talk about the engagement here to start the year and how it might have differed than what you saw last year and we've heard from some of your peers that margin balances began to rise and I think you said they're still at end of period type levels?

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

Yeah. They're definitely still at an end of period type levels. We have seen some engagement, but it's off about sort of 5% from year-end DART volumes. So margin to us and as we always talk about, it's really the indicator or the lead indicator of investor confidence in the marketplace. So that balance on our side has been up a little bit, but not in any meaningful ways since the beginning of the year.

Daniel Thomas Fannon  
Analyst, Jefferies LLC

Okay. Then just a follow up on some of the expenses. Can you clarify your marketing guidance for 2019, I think you mentioned maintaining these levels, so is that flat year-over-year? I guess, how should we think about marketing on a year-over-year basis?

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

That's correct. My prepared remarks were flat at the $200 million like we had for 2018.

Daniel Thomas Fannon  
Analyst, Jefferies LLC

Great. Thank you.

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

But Dan, just to be very clear what we said and what I said in a couple of the responses, that's an area that should we see – should we not be getting the returns that we want for the marketing dollars we're spending, we'll
either deploy it somewhere else or we'll throttle back and make the adjustments as the markets change, right. We have a very skilled and quite powerful marketing department. They know what they're doing with that cash and they know how to deploy it the right way. So, in markets like these, you start taking a look at what's the brand advertising returning for us, what are we getting from some of the cash promos and some of the other things that we do. So that's the analysis that we go through on a regular basis here. So, yes, holding it flat for budgetary purposes, but that's absolutely a lever for us.

Operator: Our next question comes from the line of Chris Harris with Wells Fargo. Your line is open. Please go ahead.

Christopher Harris
Analyst, Wells Fargo Securities LLC

Thanks. Hey, guys.

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

Hey, Chris.

Christopher Harris
Analyst, Wells Fargo Securities LLC

Three questions on Advisory Services. Thanks for the color earlier, wondering if you guys could expand a little bit more and talk to us a bit about the backlog, how many potential firms are in the backlog in Advisory Services, how much potential assets could there be? And then bigger picture type question, what are the economics as part of the business versus your retail business?

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

So, look, in terms of the Advisory Services business just bearing in mind, the reason that we really went after this in the first instance was we had a bit of a hole in our offering and that showed particularly strongly when you look at our stock plan participant population, right. So making sure that when those individuals come into cash or come into money for the first time or wealth for the first time and if it's going out to an advisor, that's just another way with our new custodian platform for us to hold on to some of those assets and really develop a relationship with that customer. So, first and foremost, let's keep in mind that that was one of the reasons we went out for this.

In terms of backlog, we've been extremely impressed with the way the business has performed, the way the brand has supported the business, and really drawn interest from the RIA marketplace in general. We stated in prepared remarks the two big ones on our national referral program that we've literally just started the pilot for are Edelman and Mercer, right. So those are two names that folks around the country know they do quite a nice job of branding. They also do quite a nice job of taking care of individual's finances. So very happy to be partnering with them.

In terms of the pipeline, we talked about it in some of the prepared remarks and some of the other conferences and on the call, we had $12 billion signed up that we believe committed for the next two years. We've onboarded it about $1 billion-plus since we started, so call it $13 billion-plus since we got started that we anticipate being on the platform over the next two years. This is very, very early days, and this is the type of response that we've had, so couldn't be more pleased.
In terms of economics, there are two different models, if you will. On the referral network side, there are three separate fee streams. One is, the custodian fee that we receive for custoding the assets on our E*TRADE Advisor Services platform known as Liberty, the second fee stream on the custodial side or the arrangement side is the cash or the cash balance that's held in the accounts. That cash behaves a little bit differently on the investment advisor side. So we have a team of individuals in our treasury who deals with that and invests it similarly to what we have, a little shorter duration, and then the third stream is the referral fee that we get paid by the RIA to whom those assets transfer to, right. So there's sort of a three-pronged approach on the referral side.

On the general custody side, it's just the custody fee and the amount that we make on the cash. In terms of our overall plan and the way that this lays out for our overall – the five-year plan, the way I look at it and the way the finance team and our management team looks at it, there is a lot of upside in the Advisor business. We didn't bake in any heroic assumptions and there's not a heck of a lot of this fee stream built into the plan. That plan was really driven by our core business and our stock plan administration business.

Christopher Harris
Analyst, Wells Fargo Securities LLC

Great, thank you.

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

Yeah.

Operator: Our next question comes from the line of Devin Ryan with JMP Securities. Your line is open. Please go ahead.

Devin Ryan
Analyst, JMP Securities LLC

Great. Good afternoon, guys.

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

Hey, Devin.

Devin Ryan
Analyst, JMP Securities LLC

This question here on Mike's comment earlier around being able to kind of toggle cash seamlessly over to the third-party banks to free up capital potentially for purchases. I just want to make sure I'm understanding this, is there any reason to do it now? It would seem to be dilutive to the near-term, I just want make sure I'm not missing something or if this is just more an opportunity in a severe rate scenario where the curve is inverted?

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

Yeah, sure. I mean, I think if you think about it now, we are still earning with the sort of marginal reinvestment rate in the sort of 300-basis-point to 325-basis-point range. Enough spread on deploying the balance sheet to earn the right return on capital relative to the cost of capital. If the short-term rates continue to rise and we see sort of a
continuation of the trends that we saw kind of emerge a bit in December, and sort of the re-investment rate falls lower the short-term rate continues to increase.

We have the ability then to really begin to start to sort of push those deposits off-balance sheet, free-up that excess capital and then deploy that capital or return that capital to a shareholder because we're going to be earning the rate. At the spreads today, it's there, it's still the right decision to proceed with the balance sheet, but the flatness of the curve is you have to factor in sort of the relative – let's sort of -in a current period, if you're right, it would be sort of immediately dilutive, but if you look at sort of the longer-term periods, you get varying outcomes from that as revenue growth continues on the smaller share count. So, looking at all of that, I would say that it's fairly close, but it's still the best decision to continue with the growth in the balance sheet overall, but the yield curve and valuation play directly into that.

Devin Ryan  
**Analyst, JMP Securities LLC**

Yeah. Okay, got it. Helpful. And then, just a follow-up here, still just want to dig in a little more on the customer cash change in the quarter, and I hear the comment on customer buying, but in December specifically, you're still just a little bit surprised relative to what we've seen from some peers. And so I'm just trying to maybe dig into that, whether it's really just a mix difference in, I guess, why you think that, and then did you see any kind of movement into as people came out of the market, margin balances declined that cash rather than going into the bank went into a money market or some other cash alternatives?

Michael A. Pizzi  
**Executive Vice President, Chief Operating Officer, E*TRADE Financial Corp.**

So just to take the last part first, we didn't see that behavior at all in terms of moving to the sidelines and cash from – straight from the margin book or coming out. We have had some nice growth in the higher interest rate savings product that we have, but that's coming from lots of different sources. We haven't seen the cannibalization or the things that the folks often talk about. So I think that instrument is doing exactly what it needs to do in forming the relationships that we like to see.

So, in terms of the business mix or other pieces, I don't talk about our competitors' business or try and get into what they do, but their models are very different. And we did see activity on a very small scale obviously on the E*TRADE Advisory Services side that would lead us to believe that many of the RIAs in the space were moving to cash. That is not big enough to move the needle on our balance sheet or on our books in any meaningful way yet, someday it will be, but not today. So I do think you have a bit of mix play there where we have more of a focus and a heavier concentration of active traders who are either pulling out or sort of getting into situations that were upside down on the margin side. That's more of what we saw, Devin. So I didn't see any of the other behaviors you were talking about. So, yeah, business mix definitely had something to do with it if you're judging us peer-to-peer.

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

And Devin, I would just add to that. On the quarter, we're still at $1.6 billion of customer net buying. That was a much stronger number coming into December. We did switch to a bit of net selling very late in the period. And of course that volatility that selling occurred right up to the record dates that we have here. It's a little bit just short-term to look at cash dynamic this quickly. We are still confident in the dynamics that we outlined really on the call last time and really what we've been outlining as we've sort of been out on the road.
And that said, the cash growth comes over time as customers build sort of account value from dividend and interest, we see customers just not sort of reinvesting as quickly, the Corporate Services proceeds that we've outlined, the size and growth of that business still remains a very compelling cash generator, nothing has really changed except the value of some of the underlying companies have gone down and, as Karl already highlighted, we are a bit technology centric there, so it's a little bit higher beta overall. But we still see that business building, we still see cash coming from that, we still see the advisor channel driving cash growth over time. So all of that leads us to a high degree of confidence in the long-term outlook. And you can even see what's happened here as we've backed up two interest rate hikes relative to the last guidance and essentially are affirming the long-term outcome. We think we are very much on track and have faith that we are going to continue along plan.

**Operator:** Our next question comes from the line of Michael Carrier with Bank of America Merrill Lynch. Your line is open. Please go ahead.

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

Thanks, guys. Just a quick one. Just on the interest earning assets — when you think — obviously a lot going on in the quarter. But when I think about 2019, and the environment where you say you exceed kind of the expectations on growth, do you think it's primarily being driven by the clients not being so aggressive on in terms of net buying? Are there other initiatives that you guys have in place that could accelerate through 2019, whether it's in the corporate side, the advisory or the core business that could grow those balances?

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

Hey, Michael; this is Chad. So, I point you to the long-term earnings side as a start and we laid out the assumptions there on what we believe around where that growth comes from and you can attribute that to the interest earning assets for 2019. Obviously that's a five-year view, but certainly that lays out a bit of our belief as it relates to 2019.

Additionally, I would point back to Karl's comments on the growth in the business. You can think about the pipeline for Corporate Services as well as the advisor channel and then just the overall wealth management product adds that we're doing and what that's going to grow in the business. And that long-term earnings slide gives you a good view of where we think that growth is going to come from so I would use that as the best proxy for.

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

Okay. Thanks a lot.

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

Thanks, Michael.

**Operator:** Our next question comes from the line of Brennan Hawken with UBS. Your line is open. Please go ahead.
Hey, guys. Thanks for taking the question. Just a quick one on deposit costs. I believe you indicated that you expect the deposit cost to continue to move higher 30 basis points in 1Q. I'm assuming that that's just a flow through from the December hike, but wanted to confirm that and ask if we end up in an environment where short-term rates are not and can actually end up moving higher. What do you think about the likelihood of deposit cost continuing to move up? How should we think about that?

The 30 basis points I mentioned – yes, that's the move from December reading through and just kind of the average coming in from Q4. There is no other that – that doesn't contemplate any other material moves in rates from that perspective. As it relates to overall long-term, the 20% beta over the long-term that I quoted, I would use that as a proxy. So, well, in any given period, it maybe ebb and flow a bit. We definitely use that 20% beta as a proxy over the long-term interest rate cycle.

And Brennan, the other thing that we obviously always keep an eye on is the competitive set to make sure that we're in line with some of our peers and we listen to our customers and what they want to need in those accounts. And that's just another thing we keep eye on.

Yeah. Right. So, I guess, the gist of my question, understanding the beta sort of requires the move in the short-term rates and the competitive dynamics and the other piece of it. When we think about prior cycles, it's my understanding that you sometimes have seen the competitive dynamics lead to continue to put pressure on deposit costs even once short-term rate hikes have sort of played out. Should we think that that might end up being a risk? Obviously it's going to depend on how the competitive dynamics work out. But is that fair to say we've seen that in past cycles?

I think the only piece that makes sense is the one you just threw out there, right, which is what do competitive forces sort of put us in the position to do. We're not going to – I mean, just keep in mind that this is still cash that we're very aware of and have done lots of analysis and data around the duration, how this cash is used in terms of investing the percentage of cash that's in the customer accounts. What it means for that customer, what they're really looking to do with that money is be on the sideline and wait to invest at the right time or transact at the right time. So, I think the only other piece to that if rates are not moving up is really the competitive dynamic.

Yeah. And Brennan, I would just add to that that we have a range of products and various products for our customers that we tailor to that are in that deposit profile. Specifically, the premium savings product for the customer that really just looking to be out of the market, we don't want that money leaving if they're just going to be sitting on cash for a long period of time. We make savings products available to them. We have certain
negotiated tiers for sort of very large customers who are sensitive to that. We have the right set of products to sort of position against the customer base. So, unless there's continued significant pressure in the competitive environment, if we don't see rates moving – if rates moving higher, I think you can say that we're going to – we try to do the best we can to sort of maintain that deposit cost.

Brennan Hawken
Analyst, UBS Securities LLC

Great. Thanks.

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

And Brennan, just to add a final note, I would just say that all of what Mike and Karl mentioned, it's all contemplated in the 30 basis points we recorded.

Brennan Hawken
Analyst, UBS Securities LLC

Thanks for the color.

Operator: Our next question comes from the line of Christian Bolu with Bernstein. Your line is open. Please go ahead.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Hello, guys.

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

Hey, Christian.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Just a quick one for me. Mike, I guess, early days in your role as COO, but as you look at the technology and operational architecture of the firm, curious where you see the most opportunity for improvement or growth?

Michael A. Pizzi
Executive Vice President, Chief Operating Officer, E*TRADE Financial Corp.

Yeah. I mean, look, we've started even before my tenure at trying to move to a more agile software design so that we can continue to innovate and drive product forth into the marketplace for our customers. I see sort of that continuing – to continue to move in that evolution to drive to being really the best-in-class really at sort of that delivery to the end customer.

Like any firm, we've got our share of things that go back and need to be updated, but we'll continue to deploy that technology in the latest way. We've been doing some work really across several areas of the firm looking at how we deploy that technology to be more efficient. We're going to continue that work into other areas of the firm this year. We have an active project pipeline of investments that we're looking at across operations. We're beginning to look in other areas where we can use the sort of the latest technology in terms of process automation,
changing sort of upstream code to take out manual process and other items. We’re really going through all of that in detail driving at towards a more efficient framework for the company. But that is just sort of more resilient overall, better for our customers, better for our employees and better at everything we do.

Operator: Our next question comes from the line of Craig Siegenthaler with Credit Suisse. Your line is open. Please go ahead.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Thanks, guys. Good evening.

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

Hi, Craig.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

So, I had a question on the new referral program. I wanted to see how it was structured. So, how do the economics flow between E*TRADE employees, RIAs in the institutional channel, and E*TRADE shareholders?

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

I mean, look, the referral network is set up such that the FC who refers into the network obviously receives some semblance of compensation that comes through with that referral going out, because it’s coming from that FC’s book. If it’s an E*TRADE client or a customer that’s on their books now and is looking for an advisor solution. Then we also have the referral RIA is paying a fee into E*TRADE where the assets that are being referred out to it and then we receive the custody fees. So it’s a fairly typical standard relationship and fees being driven, we believe, in the right way with incentives lined up to create stockholder value.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

And any color on the size of those piece of economics? And then, my last one here is, if a client moves into the institutional channel from the retail channel due to referral, how do you prevent this from driving a decline in ROCA for the clients that migrate just because in the retail channel they tend to be higher ROCA with higher cash balances and more trading.

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

Yeah. So, the way that we’ve looked at it and the data that we have is when one of our clients historically was looking at an advisor solution. They had reached a point where they were either looking for professional health in managing their assets or they were looking for – they didn’t want to do it on their own anymore, they had reached a point where self-directed investments just didn’t make sense for them, right. So they moved to an advisor solution. We lost the whole account. When you move into an RIA or an advised relationship those assets stay with E*TRADE. There is still a custodial relationship with E*TRADE. And more times than not based on the data that we have, the advisor who then holds that RIA relationship with the customer either brings in more assets or consolidates assets in that account. So, we’re actually not looking at decreasing ROCA from that customer. In
most instances in the past that just went to zero because we lost the customer, right. So to us this is a way to stem some of that and continue to have custodial fees and other fees coming in from the cash that we can manage and invest that we would have just lost in the past.

Operator: Our next question comes from the line of Will Nance with Goldman Sachs. Your line is open. Please go ahead.

Will Nance
Analyst, Goldman Sachs & Co. LLC

Hi. Good evening, guys. I wanted to ask about the full year NIM guidance. So you're guiding for 320 which is basically what we printed this quarter and there's still a rate hike left to come to the numbers. So I understand the loan portfolio run-off is a slight headwind because of lower starting point for the margin balances. I'm guessing lower ending reinvestment yields were a bit of a contributor I guess, are there any other moving pieces? And I guess if we do see further rate hikes, can you talk about how that would flow through to the operating leverage guidance or the operating margin guidance?

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

Yeah. Well, this is Chad. The 320 that we guided keep in mind, the rate hikes from September is fully baked in there, so from that perspective and December there's nothing else that will have happen from that perspective. Just with the flattening of the curve, we saw in Q4, the 300 to 325 holding that number, we're happy with that. I think that's a good number going forward for 2019. Obviously that does hold margin flat. So, any growth that you'd see there would be upside there. But that's really the way I would look at it.

Will Nance
Analyst, Goldman Sachs & Co. LLC

Got it, okay. And then I guess you highlighted that you made a few tweaks to the five-year plan assumption, so you're removing rate hikes, moving the cash from 13% to 15%. So nice to see evidence that things can change and you still feel confident in that plan. I guess related to that, given the change of commission rates this quarter and guiding I think to roughly 5% pressure next year, what gives you confidence that you know more significant commission rate pressure doesn't continue beyond next year, and I guess you know is this 5% pressure that we're seeing, in line with the kind of modest pressure that's assumed in the five year plan?

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

Yeah. So what I would say is, some of the commission pressure or other pieces, we're still in the plan at a $6.60 to $7 on CPT. That's what we see longer term. This quarter had some anomalies in it, right. The equities trades again sort of swamped out even a large level of derivatives trades that we had coming through. We still have additional individuals as we said in the prepared remarks. We've increased those customer base or our customer base has increased on the derivative side by 11%, year-on-year 11% more of those accounts have been activated and are actively trading in the derivative side. Most of that is the leg into our Power E*TRADE program where there is lower pricing point both on the trade commission and the contracts per trade price.

So you've seen some of that and when you couple it with, you know, as I would call it sort of the perfect storm in the equity markets that drove down the value of the securities held in our stock plan channel, so those folks didn't transact because it just didn't make sense at the time. You had a lot of downward pressure on CPT, right. So it was a little bit different. So I don't see the headwinds that we're talking about. What we have modeled in to get
down to that $6.60 to $7 level, over the longer-term is really the competitive rate dynamics at the higher-end of the book where individuals who do a lot of business with us and have a very good revenue model with us want to lower CPT on their overall trades because they're doing so many of them, right. But that analysis is done taking into account the full client relationship on cash, on margin, on how much they transact with us, right. What are their balances? What do they do? So that's really the way I look at it more holistically. There is no 5% commission pressure baked in.

So Chad, I don't know if you want to add anything on that.

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

Yeah. I will just point you back to the long-term earning slide in the Investor deck. Certainly, we mentioned that we talk about it moderating a bit. So there's some downward pressure in that long-term view. Also, if you look at the bottom part of that slide you can see the relative contribution that's coming from transaction based. So from that perspective, you can get a sense of how sensitive the long-term view is to additional pressure on commission pricing.

Operator: Our next question comes from the line of Brian Bedell with Deutsche Bank. Your line is open. Please go ahead.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.

All right. Great. Thanks very much. Maybe just to come back to the expense discipline. Obviously, very good in the quarter. But just to come back to that outlook of if we do get a tougher revenue environment, particularly if we end up moving into a Fed cutting environment at some point over the next 12 months, 18 months, 24 months. Just again your confidence on the 48% margin and getting to 50%? And what areas would you be able to cut costs or is it mostly on technology and through digitization or do you feel like you might have to cut into some growth initiatives if that were the case just to get to the margin?

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

So look, in any given year, any given quarter, maybe even months-to-months, there is a list of prioritize projects that we go through that we invest in for growth. We're not going to stop investing in projects that are going to drive revenue growth or somehow take a double whammy of cutting revenue production and trying to get rid of some costs. So, I think when you look across that what Mike Pizzi has been challenged to do, is really implement technology solutions across ops, across some of our customer service platforms, so that our customer service reps can spend more time talking to individuals who actually need help with their finances, right. Let's get rid of some of the calls about passwords and some other issues that are just customer dissatisfiers. Let's knock those out using and employing technology and chatbots, right, and other services that we can do. So we free up some of the human capital to really hand-hold and touch our clients in different ways.

So I think that's one piece. The other piece is obviously on the marketing side that we've talked about quite a bit. We're not going to actively be cutting or looking to pullback, but obviously if the environment softens, there are different ways to deploy and different ways to go about those strategies. And then I'll turn it over to Chad since he is intimately familiar with these scenarios.
Chad E. Turner  
Chief Financial Officer, E*TRADE Financial Corp.

Yeah. Brian, I would just reiterate the value that we have gotten both externally as well as internally from having an operating margin framework. That’s not just something we communicated with the external public, but it’s also something that is a guiding force in how we create our strategic and capital plan every year and how we make decisions at the management team and push those through all levels of the organization. So that framework has served us well and we believe it can continue to serve us well. Obviously we’ve been very committed as you’ve seen us hit those numbers and so when we commit to those numbers, we feel broadly very good about it. We think we have a lot of different levers or prioritization that we can push around to continue to grow the business while committing to this operating margin targets.

Brian Bedell  
Analyst, Deutsche Bank Securities

Great. Thanks very much. And then just maybe to the revenue side or the organic growth side. Lot of growth initiatives that you’re optimistic about putting in the RIA segment, but is there any sort of outlook to get maybe to get back to your original target of that 5.8% to 6.8% in the next one to two years? Are you optimistic? I know it’s not a technical goal right now, but are you optimistic that you think across these various growth initiatives that you can actually get up to that level closer to peers?

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

So we still believe that the growth initiatives, growth targets that we set out are the right ones for the business in the longer-term, right. Just because we stopped reporting on them, it doesn’t mean that we’re not holding ourselves to them internally and driving toward that amounts of organic growth to really continue to accelerate asset growth by bringing on more assets and also on the account growth side. But bringing in more high quality customers and relationships, right, building those rather than just looking at an aggregate number and say we opened up this many new accounts. What’s the quality of that account? What type of relationship do they have with us? Do we have the right investing solution? How can we deploy our digital wealth solutions to really drive at more customers and enhancing E*TRADE’s brand in that space, right. So moving upstream.

That’s a lot of what we’re focused on. So make no mistake about it. We are absolutely all about organic growth. And I think some of the conversations we’ve had and some of the things that we’ve tried to show you all, particularly with the supplemental deck we had last quarter, was the growth is there, right. The pipeline that we’ve filled through the Corporate Services channel is a very nice ground for us to use some of the new tools that we have at our disposal through our digital wealth offerings and through the new advisor network in our custody platform to really continue to onboard those assets and make them longer-term E*TRADE customers. And then you take a look at what we’re doing on the Advisory Services side and on the new network to drive additional asset growth. So we have not taken our eye off of organic growth whatsoever.

Operator: Our next question comes from the line of Michael Cyprys with Morgan Stanley. Your line is open. Please go ahead.

Michael J. Cyprys  
Analyst, Morgan Stanley & Co. LLC

Hey. Good evening. Thanks for taking the question. Just on the stock plan business, can you talk about how the retention rates have been trending there and what do you think is achievable in, say, the medium-term?
Karl A. Roessner  
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

So, look, retention rates have been sort of locked in at that, call it, the 15% after the 12-month period. I think the thing to keep in mind when you think about that number or that percentage is, all of the tools and all of the things that we've spoken about, whether it be from the basic robo solution to our managed account offerings, all the way up to sort of the managed product or the advisor network, all the way through the spectrum of what a client might do, client is not a self-directed trader, if you will, right, all of those are at our disposal to go out and help those stock plan participants now manage their finances on a daily basis.

That 15% moving up to 16% or 17% on the now $200-plus-billion that's in the pipeline is an enormous amount of growth for us, for our customer base, for our revenue line and dropping straight to the bottom line. None of that increase or none of that is in our model going forward, right. So that 15% with the historical rate that we've held in those accounts, none of that has been factored in. It's why we're so excited about it. It's why we talk about it all the time. We think it creates an enormous opportunity for E*TRADE going forward and it's the other reason why we continue to drive the stock plan business to onboard as many new corporate clients as they can, because it's a recurring stream for us.

So, I think it puts us in a very good position in terms of whether it's 1% or 2%. The more important thing to us is to continue to serve those corporates so that they remain steadfast E*TRADE Corporate Services clients and their stock plan participants remain in our pipes.

Michael J. Cyprys  
*Analyst, Morgan Stanley & Co. LLC*

Got it. Thanks. And then, just as a follow-up, I believe you mentioned earlier you're targeting best-in-class delivery for your clients. I guess, what does that mean for E*TRADE in terms of best-in-class delivery? And if you could also just talk about more broadly the customer experience, sort of where do you see that in three years and how different could that be?

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

So, when I think about customer experience, I think about and I talk about quite a bit what our vision is internally, right, as E*TRADE. And when we talk and it's plastered on all of our walls around our site, it's on our employees' desks and their computers, it's to be the number one digital broker and advisor to traders and investors known for ease of use and completeness of offering, right.

So, the last two, I think, address your question in the biggest way, which is ease of use and completeness of offering. From the first touch as a customer, you need a mobile device, a mobile application, easy to download, easy to sign on to, ease of use on an online application, easy to find tools and services, a very simple chatbot that you can interact with if you don't like to talk to a human being or a very nice customer service rep on the other side if you need help and you want some hand-holding.

Right, that's the beginning of it all. And then what happens once you sign in and you log into that environment, and now you're in E*TRADE's site, right. So you've gone in, you've logged in, you're a customer. Does it look the same? Does it feel the same? Is it easy to move around? Can you get what you look for in one click, right? Can you drop down a menu, not a hamburger and one of the sites that you have that's very hard to pull down, but can you sort of hover above it and see everything you want to see on that site and get right to it without getting confused? Is the education offering complete? Is it easy to use? Is it easy to understand? Right. So, I like your
time horizon but we need to get there a lot quicker. I think we are very good today. We need to be great tomorrow, right. That's what E*TRADE has to be. We've always been the innovator and a disruptor in this space.

To me today, innovation has to start with what does your customer want? Right. What kind of interaction does your customer want from you? What do they demand out of the device? What do they demand from your platform? You have to read that upfront, you have to have the right data and analytics and you need to drive it home all the way across your platform and site and every person in your organization. From the first touch all the way through senior management, all the way up to our board needs to know that that customer is first and foremost and our existence and reason for being, right. So, it's a long-winded answer, but over a three-year period that's where we need to be. But it doesn't stop at three years, you got to constantly innovate, you have to constantly listen to the feedback loop, what are your customers saying? What are the new market entrants? Right. We talk about all the time as a management team.

Yeah, there's a lot of really cool technology out there really easy apps to use, really nice things that people can do. What can we learn from that? What type of customer does that draw? What type of account does it open? How often do they interact? What types of balances do they bring? Do we want to offer that type of service? Does it cannibalize what we have? That's what we think about every day.

So the question you just asked is at the centerpiece of everything we strategically do as an executive committee here at the firm all the way through our reason for being. So, it's a great question, and I think it has to start with customer first, completeness of offering, ease of use, it's simple as that.

**Operator:** Our next question comes from the line of Kyle Voigt with KBW. Your line is open please go ahead.

**Kyle Voigt**
*Analyst, Keefe, Bruyette & Woods, Inc.*

Hi. Good evening. Just on the high yield savings offering, we certainly see some nice growth in those deposits. Just wondering if you could share any stats on either your share of wallet or attrition rates with brokerage customers that have that banking relationship with you versus those that don't, because just in terms of use of capital, I would think that you're generating a much lower NIM on the balance sheet growth funded with that high-yield saving deposit growth, for example. So just trying to understand the other benefits and considerations for you when you're growing that business.

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

Hey, Kyle. The way we think about it would be, there's lots of opportunities in different products we have to give customers who are looking for a little more rate. Certainly premium savings has been operating as good as we've been expecting or even better. The way we think about it is a couple fold; one, you have brokerage customers that are looking for a rate and they may go somewhere else and then we've seen them go in there. I'd also note that we've seen a lot of external flows coming in there. So, as existing clients are opening a premium savings account and putting some money in there, they're also bringing other money in from other financial institutions, which is a good sign. And then we've seen lots of growth from new customers bank-only.

And then, lastly, I would say, our bank products historically you've seen that those have been running off slowly, some of the legacy products we've had on the savings side. The nice thing we've seen here is that this has been an opportunity for those customers that have been leaving historically. They've been actually coming over to the premium savings account, so we're seeing a nice capture of those balances that we would have normally
historically lost. As we know, just as far as brokerage customers with bank relationships, we’ve talked before about how brokerage customers who have banking relationships trade more, they have lower attrition rates and they do more of their business with us. And so, from that perspective, that’s also been a really positive sign with premium savings.

Kyle Voigt  
Analyst, Keefe, Bruyette & Woods, Inc.

Okay. And just a follow-up on the expanding securities portfolio to include other asset-backed securities, can you just confirm whether or not that's already reflected in the NIM guidance and do you anticipate on growing the asset-backed portfolio to that 4% of earning assets by year end 2019 or do you expect to get there sooner?

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

Yeah. Given a very slow methodical build out, it’s not material to the NIM guidance for this year. So, I think the NIM guidance is really – it’s really not in the NIM guidance, but I don’t think it would make a difference given the relatively small sizes we’re talking about. Obviously as we get into outyears, it could have a more meaningful impact.

Operator: At this time, I’d like to turn the call back over to our presenters for any final remarks.

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

Thank you all for joining us. We look forward to hearing from you and talking with you next quarter. Good night.

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