

**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 September 30, 2013

or

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

Commission File Number 1-11921

E*TRADE Financial Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

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

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

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

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

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

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

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

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

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

As of November 1, 2013, there were 287,198,016 shares of common stock outstanding.

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FORM 10-Q QUARTERLY REPORT
For the Quarter Ended September 30, 2013
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*Unless otherwise indicated, references to "the Company," "we," "us," "our" and "E*TRADE" mean E*TRADE Financial Corporation and its subsidiaries.*

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FORWARD-LOOKING STATEMENTS

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

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

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

GLOSSARY OF TERMS

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

OVERVIEW

Strategy

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

- *Strengthening our overall financial and franchise position.* We are focused on achieving a more efficient distribution of capital between our regulated entities by: generating capital through earnings, de-risking the balance sheet, maintaining disciplined expense control, and enhancing our enterprise-wide risk management culture and capabilities.
- *Improving our market position in our retail brokerage business.* We plan to accelerate the growth of our customer franchise through new customer acquisition and increasing engagement with existing customers. We also strive to continue enhancing the customer experience, improving satisfaction and retention.
- *Capitalizing on the value of our corporate services business.* We are focused on growing this strategically important channel. By better serving the needs of our corporate clients and deepening engagement with our stock plan participants, our retail brokerage business will realize additional economic benefit.
- *Enhancing our position in retirement, investing and savings.* We are focused on expanding our customers’ awareness and preference for our retirement, investing and savings products and services as a key component of our long term success.
- *Continuing to manage and de-risk the Bank.* We are focused on optimizing the value of customer deposits, while continuing to mitigate credit losses in our loan portfolio, and improving the Bank’s risk profile.

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Key Factors Affecting Financial Performance

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

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

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

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

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

| | As of or For the Three Months Ended September 30, | | | As of or For the Nine Months Ended September 30, | | |
|--|---|-----------|---------------------------|--|-----------|---------------------------|
| | 2013 | 2012 | Variance 2013 vs. 2012 | 2013 | 2012 | Variance 2013 vs. 2012 |
| Customer Activity Metrics: | | | | | | |
| Daily average revenue trades ("DARTs") | 145,150 | 128,701 | 13% | 147,777 | 141,399 | 5% |
| Average commission per trade | \$ 11.15 | \$ 11.24 | (1)% | \$ 11.18 | \$ 10.98 | 2% |
| Margin receivables (dollars in billions) | \$ 6.2 | \$ 5.6 | 11% | \$ 6.2 | \$ 5.6 | 11% |
| End of period brokerage accounts | 2,975,842 | 2,892,852 | 3% | 2,975,842 | 2,892,852 | 3% |
| Net new brokerage accounts | 13,111 | 18,247 | (28)% | 72,651 | 109,840 | (34)% |
| Annualized brokerage account attrition rate | 9.0% | 8.5% | * | 8.7% | 8.7% | * |
| Customer assets (dollars in billions) | \$ 240.6 | \$ 204.1 | 18% | \$ 240.6 | \$ 204.1 | 18% |
| Net new brokerage assets (dollars in billions) | \$ 2.4 | \$ 1.9 | 26% | \$ 7.2 | \$ 8.1 | (11)% |
| Brokerage related cash (dollars in billions) | \$ 38.2 | \$ 32.6 | 17% | \$ 38.2 | \$ 32.6 | 17% |
| Company Financial Metrics: | | | | | | |
| Corporate cash (dollars in millions) | \$ 372.9 | \$ 430.8 | (13)% | \$ 372.9 | \$ 430.8 | (13)% |
| E*TRADE Financial Tier 1 leverage ratio | 6.6% | 5.8% | 0.8% | 6.6% | 5.8% | 0.8% |
| E*TRADE Financial Tier 1 common ratio | 12.9% | 10.9% | 2.0% | 12.9% | 10.9% | 2.0% |
| E*TRADE Bank Tier 1 leverage ratio | 9.5% | 7.9% | 1.6% | 9.5% | 7.9% | 1.6% |
| Special mention loan delinquencies (dollars in millions) | \$ 278.1 | \$ 327.4 | (15)% | \$ 278.1 | \$ 327.4 | (15)% |
| Allowance for loan losses (dollars in millions) | \$ 458.9 | \$ 508.3 | (10)% | \$ 458.9 | \$ 508.3 | (10)% |
| Enterprise net interest spread | 2.30% | 2.28% | 0.02% | 2.32% | 2.41% | (0.09)% |
| Enterprise interest-earning assets (average dollars in billions) | \$ 40.8 | \$ 44.9 | (9)% | \$ 40.6 | \$ 44.8 | (9)% |

* Percentage not meaningful.

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Customer Activity Metrics

- DARTs are the predominant driver of commissions revenue from our customers.
- Average commission per trade is an indicator of changes in our customer mix, product mix and/or product pricing.
- Margin receivables represent credit extended to customers to finance their purchases of securities by borrowing against securities they own 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.
- Brokerage related cash is an indicator of the level of engagement with our brokerage customers and is a key driver of net operating interest income.

Company Financial Metrics

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

Significant Events in the Third Quarter of 2013

*\$100 Million Dividend Issued from E*TRADE Bank to the Parent Company*

- We received approval from our regulators for a \$100 million dividend from E*TRADE Bank to the parent company, reflecting significant progress on our long-term capital plan.

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Sale of the Market Making Business and Related Order Flow Agreement

- We entered into a definitive agreement to sell the market making business, G1 Execution Services, LLC (“G1X”) to an affiliate of Susquehanna International Group, LLP (“Susquehanna”) for approximately \$75 million, subject to regulatory approval. We do not expect the sale of the market making business to have a material impact on our results of operations as the net impact of the removal of principal transaction revenue and associated operating expenses, predominately in compensation and clearing expenses, will be offset by an expected increase in order flow revenue as a result of routing all of our order flow to third parties.
- Additionally, we will enter into an order flow agreement whereby we agree, subject to best execution standards, to route 70% of our customer equity flow to G1X over the next five years.

EARNINGS OVERVIEW

We generated net income of \$47.4 million and \$28.1 million, or \$0.16 and \$0.10 per diluted share, on total net revenue of \$416.8 million and \$1.3 billion for the three and nine months ended September 30, 2013, respectively. Net operating interest income decreased 8% and 12% to \$240.9 million and \$724.7 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012, driven primarily by decreases in enterprise interest-earning assets and enterprise interest-bearing liabilities as a result of our deleveraging initiatives. Commissions, fees and service charges, principal transactions and other revenue increased 8% and 5% to \$164.3 million and \$505.2 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. In addition, gains on loans and securities, net decreased 85% and 65% to \$12.2 million and \$49.0 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012.

Provision for loan losses declined 73% to \$37.4 million and 55% to \$126.2 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decline was driven primarily by improving credit trends and loan portfolio run-off, as well as a \$12.5 million benefit from a settlement with a third party mortgage originator that was recorded in the first quarter of 2013. Total operating expenses decreased 6% to \$270.7 million and increased 12% to \$980.2 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decrease for the three months ended September 30, 2013 was driven primarily by a decrease in FDIC insurance expense, and the increase for nine months ended September 30, 2013 was driven primarily by \$142.4 million in impairment of goodwill that was recognized in the second quarter of 2013.

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

Revenue

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

| | Three Months | | Variance | | Nine Months | | Variance | |
|------------------------------------|---------------------|----------|---------------|-------|---------------------|------------|---------------|-------|
| | Ended September 30, | | 2013 vs. 2012 | | Ended September 30, | | 2013 vs. 2012 | |
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Net operating interest income | \$ 240.9 | \$ 260.9 | \$(20.0) | (8)% | \$ 724.7 | \$ 824.8 | \$(100.1) | (12)% |
| Commissions | 102.8 | 90.4 | 12.4 | 14% | 309.8 | 291.2 | 18.6 | 6% |
| Fees and service charges | 39.9 | 30.9 | 9.0 | 29% | 112.8 | 92.0 | 20.8 | 23% |
| Principal transactions | 12.6 | 22.1 | (9.5) | (43)% | 55.6 | 67.5 | (11.9) | (18)% |
| Gains on loans and securities, net | 12.2 | 79.0 | (66.8) | (85)% | 49.0 | 138.6 | (89.6) | (65)% |
| Net impairment | (0.6) | (2.4) | 1.8 | (76)% | (2.3) | (11.2) | 8.9 | (79)% |
| Other revenues | 9.0 | 9.1 | (0.1) | (0)% | 27.0 | 28.9 | (1.9) | (6)% |
| Total non-interest income | 175.9 | 229.1 | (53.2) | (23)% | 551.9 | 607.0 | (55.1) | (9)% |
| Total net revenue | \$ 416.8 | \$ 490.0 | \$(73.2) | (15)% | \$ 1,276.6 | \$ 1,431.8 | \$(155.2) | (11)% |

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Net Operating Interest Income

Net operating interest income decreased 8% to \$240.9 million and 12% to \$724.7 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. Net operating interest income is earned primarily through investing customer payables and deposits in enterprise interest-earning assets, which include: real estate loans, margin receivables, available-for-sale securities and held-to-maturity securities.

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

| | Three Months Ended September 30, | | | | | |
|--|----------------------------------|------------------------------|---------------------|-------------------|------------------------------|---------------------|
| | 2013 | | | 2012 | | |
| | Average Balance | Operating Interest Inc./Exp. | Average Yield/ Cost | Average Balance | Operating Interest Inc./Exp. | Average Yield/ Cost |
| Enterprise interest-earning assets: | | | | | | |
| Loans ⁽¹⁾ | \$ 9,288.3 | \$ 96.4 | 4.15% | \$ 11,727.3 | \$ 118.7 | 4.05% |
| Available-for-sale securities | 13,011.1 | 68.7 | 2.11% | 14,992.7 | 82.9 | 2.21% |
| Held-to-maturity securities | 9,853.1 | 64.5 | 2.62% | 8,984.6 | 62.0 | 2.76% |
| Margin receivables | 5,938.3 | 56.1 | 3.75% | 5,604.0 | 55.5 | 3.94% |
| Cash and equivalents | 1,543.7 | 0.8 | 0.20% | 2,268.8 | 1.2 | 0.21% |
| Segregated cash | 516.8 | 0.1 | 0.09% | 693.1 | 0.1 | 0.07% |
| Securities borrowed and other | 661.0 | 11.8 | 7.08% | 582.8 | 11.9 | 8.12% |
| Total enterprise interest-earning assets | 40,812.3 | 298.4 | 2.92% | 44,853.3 | 332.3 | 2.96% |
| Non-operating interest-earning and non-interest earning assets ⁽²⁾ | 4,311.5 | | | 4,724.1 | | |
| Total assets | \$45,123.8 | | | \$49,577.4 | | |
| Enterprise interest-bearing liabilities: | | | | | | |
| Deposits | \$25,804.3 | 3.3 | 0.05% | \$28,631.4 | 5.8 | 0.08% |
| Customer payables | 5,547.9 | 2.1 | 0.15% | 5,646.2 | 2.9 | 0.20% |
| Securities sold under agreements to repurchase | 4,445.6 | 37.4 | 3.29% | 4,709.2 | 40.1 | 3.34% |
| Federal Home Loan Bank ("FHLB") advances and other borrowings | 1,291.7 | 17.2 | 5.20% | 2,622.3 | 24.2 | 3.60% |
| Securities loaned and other | 874.2 | — | 0.01% | 705.2 | — | 0.02% |
| Total enterprise interest-bearing liabilities | 37,963.7 | 60.0 | 0.62% | 42,314.3 | 73.0 | 0.68% |
| Non-operating interest-bearing and non-interest bearing liabilities ⁽³⁾ | 2,383.0 | | | 2,155.6 | | |
| Total liabilities | 40,346.7 | | | 44,469.9 | | |
| Total shareholders' equity | 4,777.1 | | | 5,107.5 | | |
| Total liabilities and shareholders' equity | \$45,123.8 | | | \$49,577.4 | | |
| Excess of enterprise interest-earning assets over enterprise interest-bearing liabilities/Enterprise net interest income/Spread | \$ 2,848.6 | \$ 238.4 | 2.30% | \$ 2,539.0 | \$ 259.3 | 2.28% |
| Enterprise net interest margin (net yield on enterprise interest-earning assets) | | | 2.34% | | | 2.31% |
| Ratio of enterprise interest-earning assets to enterprise interest-bearing liabilities | | | 107.50% | | | 106.00% |
| Return on average: | | | | | | |
| Total assets | | | 0.42% | | | (0.23)% |
| Total shareholders' equity | | | 3.97% | | | (2.20)% |
| Average equity to average total assets | | | 10.59% | | | 10.30% |

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

| | Three Months Ended September 30, | |
|--|----------------------------------|-----------------|
| | 2013 | 2012 |
| Enterprise net interest income | \$ 238.4 | \$ 259.3 |
| Taxable equivalent interest adjustment | (0.3) | (0.3) |
| Earnings on customer assets held by third parties ⁽⁴⁾ | 2.8 | 1.9 |
| Net operating interest income | <u>\$ 240.9</u> | <u>\$ 260.9</u> |

- (1) Nonaccrual loans are included in the average loan balances. Interest payments received on nonaccrual loans are recognized on a cash basis in operating interest income until it is doubtful that full payment will be collected, at which point payments are applied to principal.
- (2) Non-operating interest-earning and non-interest earning assets consist of certain segregated cash balances, property and equipment, net, goodwill, other intangibles, net and other assets that do not generate operating interest income. Some of these assets generate corporate interest income.
- (3) Non-operating interest-bearing and non-interest bearing liabilities consist of corporate debt and other liabilities that do not generate operating interest expense. Some of these liabilities generate corporate interest expense.
- (4) Includes revenue earned on average customer assets of \$12.0 billion and \$3.9 billion for the three months ended September 30, 2013 and 2012, respectively, held by third parties outside the Company, including money market funds and sweep deposit accounts at unaffiliated financial institutions. Fees earned on the customer assets are based on the federal funds rate plus a negotiated spread or other contractual arrangement with the third party institutions.

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| | Nine Months Ended September 30, | | | | | |
|--|---------------------------------|------------------------------|---------------------|-----------------|------------------------------|---------------------|
| | 2013 | | | 2012 | | |
| | Average Balance | Operating Interest Inc./Exp. | Average Yield/ Cost | Average Balance | Operating Interest Inc./Exp. | Average Yield/ Cost |
| Enterprise interest-earning assets: | | | | | | |
| Loans ⁽¹⁾ | \$ 9,828.3 | \$ 305.2 | 4.14% | \$12,339.3 | \$ 383.2 | 4.14% |
| Available-for-sale securities | 12,799.3 | 199.8 | 2.08% | 15,791.6 | 287.5 | 2.43% |
| Held-to-maturity securities | 9,709.1 | 183.8 | 2.52% | 8,007.2 | 175.6 | 2.92% |
| Margin receivables | 5,761.0 | 164.5 | 3.82% | 5,365.8 | 158.9 | 3.95% |
| Cash and equivalents | 1,500.5 | 2.3 | 0.21% | 1,665.4 | 2.6 | 0.21% |
| Segregated cash | 382.3 | 0.3 | 0.10% | 1,086.8 | 0.6 | 0.07% |
| Securities borrowed and other | 644.3 | 38.0 | 7.89% | 581.7 | 37.2 | 8.55% |
| Total enterprise interest-earning assets | 40,624.8 | 893.9 | 2.94% | 44,837.8 | 1,045.6 | 3.11% |
| Non-operating interest-earning and non-interest earning assets ⁽²⁾ | 4,715.3 | | | 4,590.3 | | |
| Total assets | \$45,340.1 | | | \$49,428.1 | | |
| Enterprise interest-bearing liabilities: | | | | | | |
| Deposits | \$26,113.4 | \$ 9.7 | 0.05% | \$28,381.8 | \$ 20.8 | 0.10% |
| Customer payables | 5,301.7 | 5.7 | 0.14% | 5,638.3 | 8.4 | 0.20% |
| Securities sold under agreements to repurchase | 4,454.5 | 111.1 | 3.29% | 4,833.3 | 121.4 | 3.30% |
| Federal Home Loan Bank ("FHLB") advances and other borrowings | 1,280.2 | 51.2 | 5.27% | 2,695.6 | 75.0 | 3.65% |
| Securities loaned and other | 827.0 | 0.1 | 0.01% | 665.5 | 0.2 | 0.05% |
| Total enterprise interest-bearing liabilities | 37,976.8 | 177.8 | 0.62% | 42,214.5 | 225.8 | 0.70% |
| Non-operating interest-bearing and non-interest bearing liabilities ⁽³⁾ | 2,490.1 | | | 2,168.7 | | |
| Total liabilities | 40,466.9 | | | 44,383.2 | | |
| Total shareholders' equity | 4,873.2 | | | 5,044.9 | | |
| Total liabilities and shareholders' equity | \$45,340.1 | | | \$49,428.1 | | |
| Excess of enterprise interest-earning assets over enterprise interest-bearing liabilities/Enterprise net interest income/Spread | | | | | | |
| | \$ 2,648.0 | \$ 716.1 | 2.32% | \$ 2,623.3 | \$ 819.8 | 2.41% |
| Enterprise net interest margin (net yield on enterprise interest-earning assets) | | | 2.35% | | | 2.44% |
| Ratio of enterprise interest-earning assets to enterprise interest-bearing liabilities | | | 106.97% | | | 106.21% |
| Return on average: | | | | | | |
| Total assets | | | 0.08% | | | 0.20% |
| Total shareholders' equity | | | 0.77% | | | 1.90% |
| Average equity to average total assets | | | 10.75% | | | 10.21% |

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

| | Nine Months Ended September 30, | |
|--|---------------------------------|----------|
| | 2013 | 2012 |
| Enterprise net interest income | \$ 716.1 | \$ 819.8 |
| Taxable equivalent interest adjustment | (0.8) | (0.9) |
| Earnings on customer assets held by third parties ⁽⁴⁾ | 9.4 | 5.9 |
| Net operating interest income | \$ 724.7 | \$ 824.8 |

- (1) Nonaccrual loans are included in the average loan balances. Interest payments received on nonaccrual loans are recognized on a cash basis in operating interest income until it is doubtful that full payment will be collected, at which point payments are applied to principal.
- (2) Non-operating interest-earning and non-interest earning assets consist of certain segregated cash balances, property and equipment, net, goodwill, other intangibles, net and other assets that do not generate operating interest income. Some of these assets generate corporate interest income.
- (3) Non-operating interest-bearing and non-interest bearing liabilities consist of corporate debt and other liabilities that do not generate operating interest expense. Some of these liabilities generate corporate interest expense.
- (4) Includes revenue earned on average customer assets of \$10.9 billion and \$3.7 billion for the nine months ended September 30, 2013 and 2012, respectively, held by third parties outside the Company, including money market funds and sweep deposit accounts at unaffiliated financial institutions. Fees earned on the customer assets are based on the federal funds rate plus a negotiated spread or other contractual arrangement with the third party institutions.

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The fluctuation in enterprise interest-earning assets is driven primarily by changes in enterprise interest-bearing liabilities, specifically customer payables and deposits. Average enterprise interest-earning assets decreased 9% to \$40.8 billion and 9% to \$40.6 billion for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decreases in average enterprise interest-earning assets were primarily a result of decreases in average loans, average available-for-sale securities and average segregated cash.

Average enterprise interest-bearing liabilities decreased 10% to \$38.0 billion for both the three and nine months ended September 30, 2013, compared to the same periods in 2012. The decreases in average enterprise interest-bearing liabilities were primarily a result of our deleveraging strategy which drove decreases in average deposits and average FHLB advances and other borrowings.

As part of our strategy to strengthen our overall financial and franchise position we have been focused on improving our capital ratios by reducing risk and deleveraging the balance sheet. Our deleveraging strategy included transferring customer deposits to third party institutions. At September 30, 2013, our customers held \$12.9 billion of assets at third party institutions, including third party banks and money market funds. Approximately 67% of these off-balance sheet assets are as a result of our deleveraging efforts. We estimate the impact of our deleveraging efforts on net operating interest income to be approximately 115 basis points based on the estimated current re-investment rates on these assets, less approximately 35 basis points of cost associated with holding these assets on our balance sheet, primarily, FDIC insurance premiums. While we may take some tactical actions in future periods, we consider our deleveraging initiatives to be complete; therefore, any future impact on net operating interest income and pre-tax earnings will be driven primarily by fluctuations in the interest rate environment.

Enterprise net interest spread increased by two basis points to 2.30% and decreased nine basis points to 2.32% for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012, due to lower yields on margin and reinvestment at lower rates in the current interest rate environment, partially offset by lower rates on customer payables and deposits. We expect enterprise net interest spread will average slightly above 230 basis points for the full year 2013; however, enterprise net interest spread may further fluctuate based on the size and mix of the balance sheet, as well as the impact from the level of interest rates.

Commissions

Commissions revenue increased 14% to \$102.8 million and 6% to \$309.8 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The main factors that affect commissions are DARTs, average commission per trade and the number of trading days during the period.

DART volume increased 13% to 145,150 and 5% to 147,777 for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. Option-related DARTs as a percentage of total DARTs represented 24% of trading volume for both the three and nine months ended September 30, 2013 compared to 25% and 24%, respectively, for the same periods in 2012. Exchange-traded funds-related DARTs as a percentage of total DARTs represented 7% and 8% of trading volume for the three and nine months ended September 30, 2013, respectively, compared to 8% for both the same periods in 2012.

Average commission per trade decreased 1% to \$11.15 and increased 2% to \$11.18 for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. Average commission per trade is impacted by customer mix and the different commission rates on various trade types (e.g. equities, options, futures, fixed income, stock plan, exchange-traded funds, mutual funds, forex and cross border). Accordingly, changes in the mix of trade types will impact average commission per trade.

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Fees and Service Charges

Fees and service charges increased 29% to \$39.9 million and 23% to \$112.8 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The table below shows the components of fees and service charges and the resulting variances (dollars in millions):

| | Three Months Ended | | Variance | | Nine Months Ended | | Variance | |
|--------------------------------|--------------------|----------------|---------------|------|-------------------|----------------|----------------|------|
| | September 30, | | 2013 vs. 2012 | | September 30, | | 2013 vs. 2012 | |
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Order flow revenue | \$ 18.8 | \$ 15.0 | \$ 3.8 | 25% | \$ 52.5 | \$ 43.7 | \$ 8.8 | 20% |
| Mutual fund service fees | 5.1 | 4.2 | 0.9 | 23% | 15.8 | 12.0 | 3.8 | 32% |
| Foreign exchange revenue | 3.9 | 2.6 | 1.3 | 53% | 10.9 | 8.1 | 2.8 | 34% |
| Advisor management fees | 3.6 | 1.8 | 1.8 | 108% | 9.4 | 4.3 | 5.1 | 119% |
| Reorganization fees | 2.8 | 2.0 | 0.8 | 45% | 6.2 | 5.6 | 0.6 | 10% |
| Other fees and service charges | 5.7 | 5.3 | 0.4 | 4% | 18.0 | 18.3 | (0.3) | (2)% |
| Total fees and service charges | <u>\$ 39.9</u> | <u>\$ 30.9</u> | <u>\$ 9.0</u> | 29% | <u>\$ 112.8</u> | <u>\$ 92.0</u> | <u>\$ 20.8</u> | 23% |

The increases in fees and services charges for the three and nine months ended September 30, 2013 were driven primarily by increases in order flow revenue due to increased trading activity, as well as increases in advisor management fees driven by an increase in our retirement, investing and savings products, which were \$2.1 billion as of September 30, 2013, compared to \$1.1 billion as of September 30, 2012.

Currently the market making business, G1X, has a formal intercompany agreement with E*TRADE Securities LLC ("ETS"), both wholly owned consolidated subsidiaries of the Company. As part of the intercompany agreement, ETS routes a portion of its order flow to G1X, and receives an order flow rebate which is eliminated in consolidation. After closing the sale of the market making business, we expect to see an increase in order flow revenue as ETS will be routing all of its order flow to third parties.

Principal Transactions

Principal transactions decreased 43% to \$12.6 million and 18% to \$55.6 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. Principal transactions are derived from our market making business in which we act as a market maker for our brokerage customers' orders as well as orders from third party customers. The decreases in principal transactions revenue were driven primarily by lower levels of shares traded and of market volatility in the three and nine months ended September 30, 2013 when compared to the same periods in 2012.

The market making business generates all of our principal transactions revenue. On October 23, 2013, we entered into a definitive agreement to sell the market making business to an affiliate of Susquehanna. Upon closing of the sale, we will no longer have principal transactions revenue.

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Gains on Loans and Securities, Net

Gains on loans and securities, net decreased 85% to \$12.2 million and 65% to \$49.0 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The table below shows the activity and resulting variances (dollars in millions):

| | Three Months Ended | | Variance | | Nine Months Ended | | Variance | |
|---|--------------------|---------|---------------|-------|-------------------|----------|---------------|-------|
| | September 30, | | 2013 vs. 2012 | | September 30, | | 2013 vs. 2012 | |
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Gains (losses) on loans, net | \$ (0.6) | \$ 0.2 | \$ (0.8) | * | \$ (0.8) | \$ 0.4 | \$ (1.2) | * |
| Gains on available-for-sale securities, net | 15.7 | 80.1 | (64.4) | (80)% | 49.4 | 145.1 | (95.7) | (66)% |
| Losses on trading securities, net | — | — | — | * | — | (0.1) | 0.1 | * |
| Hedge ineffectiveness | (2.9) | (1.3) | (1.6) | * | 0.4 | (6.8) | 7.2 | * |
| Gains on securities, net | 12.8 | 78.8 | (66.0) | (84)% | 49.8 | 138.2 | (88.4) | (64)% |
| Gains on loans and securities, net | \$ 12.2 | \$ 79.0 | \$ (66.8) | (85)% | \$ 49.0 | \$ 138.6 | \$ (89.6) | (65)% |

* Percentage not meaningful.

The decreases in gains on loans and securities net for the three and nine months ended September 30, 2013, were driven by additional gains recognized in the prior periods from the sale of available-for-sale securities as a result of our deleveraging initiatives, primarily related to a reduction in wholesale funding obligations.

Net Impairment

We recognized \$0.6 million and \$2.3 million of net impairment during the three and nine months ended September 30, 2013, respectively, on certain securities in our non-agency CMO portfolio due to continued deterioration in the expected credit performance of the underlying loans in those specific securities. The gross other-than-temporary impairment (“OTTI”) and the noncredit portion of OTTI, which was, or had been previously, recorded through other comprehensive income, are shown in the table below (dollars in millions):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Other-than-temporary impairment (“OTTI”) | \$ — | \$ (2.1) | \$ (0.6) | \$ (16.1) |
| Less: noncredit portion of OTTI recognized into (out of) other comprehensive income (before tax) | (0.6) | (0.3) | (1.7) | 4.9 |
| Net impairment | \$ (0.6) | \$ (2.4) | \$ (2.3) | \$ (11.2) |

Provision for Loan Losses

Provision for loan losses decreased 73% to \$37.4 million and 55% to \$126.2 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decrease in provision for loan losses was driven primarily by improving credit trends, as evidenced by the lower levels of delinquent loans in the one- to four-family and home equity loan portfolios, and loan portfolio run-off. The provision for loan losses has declined 93% from its peak of \$517.8 million in the third quarter of 2008. We expect provision for loan losses to continue to decline over the long term, although it is subject to variability in any given quarter.

During the three and nine months ended September 30, 2013, we evaluated and refined our default assumptions related to a subset of the home equity line of credit portfolio that will require borrowers to repay the loan in full at the end of the draw period, commonly referred to as “balloon loans”. These loans were approximately \$250 million of the home equity line of credit portfolio at September 30, 2013. We evaluated the

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significant burden a balloon payment may place on a borrower with a low Fair Isaac Credit Organization (“FICO”) score and high combined loan-to-value (“CLTV”) ratio, and examined those loans within the balloon portfolio. We refined our expectations and estimates around the time period that it might take for these borrowers’ equity positions in their collateral to appreciate in order to allow for possible refinance of the balloon loan at maturity. As a result of this evaluation, we increased our default assumptions and extended the period of management’s forecasted loan losses captured within the general allowance to include the total probable loss on this subset of balloon loans. The overall impact of these enhancements drove the majority of provision for loan losses during the three and nine months ended September 30, 2013.

During the three and nine months ended September 30, 2012, provision for loan losses included approximately \$50 million in charge-offs associated with newly identified bankruptcy filings, with approximately 80% related to prior years. We utilize third party loan servicers to obtain bankruptcy data on our borrowers and during the third quarter of 2012, we identified an increase in bankruptcies reported by one specific servicer. In researching this increase, we discovered that the servicer had not been reporting historical bankruptcy data on a timely basis. As a result, we implemented an enhanced procedure around all servicer reporting to corroborate bankruptcy reporting with independent third party data. Through this additional process, approximately \$90 million of loans were identified in which servicers failed to report the bankruptcy filing to us, approximately 90% of which were current at September 30, 2012. As a result, these loans were written down to the estimated current value of the underlying property less estimated selling costs, or approximately \$40 million, during the third quarter of 2012. These charge-offs resulted in an increase to the provision for loan losses of \$50 million for the three months ended September 30, 2012.

Operating Expense

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

| | Three Months Ended September 30, | | Variance 2013 vs. 2012 | | Nine Months Ended September 30, | | Variance 2013 vs. 2012 | |
|--|-------------------------------------|-----------------|---------------------------|-------------|------------------------------------|-----------------|---------------------------|------------|
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Compensation and benefits | \$ 88.4 | \$ 94.8 | \$ (6.4) | (7)% | \$ 270.1 | \$ 272.6 | \$ (2.5) | (1)% |
| Advertising and market development | 20.9 | 26.1 | (5.2) | (20)% | 80.8 | 110.2 | (29.4) | (27)% |
| Clearing and servicing | 30.9 | 30.8 | 0.1 | 0% | 93.6 | 98.2 | (4.6) | (5)% |
| FDIC insurance premiums | 24.7 | 31.3 | (6.6) | (21)% | 79.1 | 86.9 | (7.8) | (9)% |
| Professional services | 22.9 | 20.4 | 2.5 | 12% | 58.8 | 60.7 | (1.9) | (3)% |
| Occupancy and equipment | 17.7 | 19.4 | (1.7) | (9)% | 53.3 | 55.5 | (2.2) | (4)% |
| Communications | 15.3 | 17.5 | (2.2) | (13)% | 52.4 | 55.0 | (2.6) | (5)% |
| Depreciation and amortization | 21.8 | 23.1 | (1.3) | (5)% | 67.7 | 68.4 | (0.7) | (1)% |
| Amortization of other intangibles | 5.7 | 6.3 | (0.6) | (9)% | 17.8 | 18.9 | (1.1) | (6)% |
| Impairment of goodwill | — | — | — | * | 142.4 | — | 142.4 | * |
| Facility restructuring and other exit activities | 6.4 | 2.3 | 4.1 | * | 23.9 | 3.5 | 20.4 | * |
| Other operating expenses | 16.0 | 17.0 | (1.0) | (5)% | 40.3 | 46.8 | (6.5) | (14)% |
| Total operating expense | \$ 270.7 | \$ 289.0 | \$(18.3) | (6)% | \$ 980.2 | \$ 876.7 | \$103.5 | 12% |

* Percentage not meaningful

Compensation and Benefits

Compensation and benefits decreased 7% to \$88.4 million and 1% to \$270.1 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decreases in compensation and benefits were driven primarily by lower salary expense as a result of headcount reductions and

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lower severance costs when compared to the same periods in 2012. During the nine months ended September 30, 2013, we recorded \$4.5 million in severance associated with executive terminations compared to \$13 million in severance recorded in the same period in 2012, related to the departure of our former Chief Executive Officer.

Advertising and Market Development

Advertising and market development decreased 20% to \$20.9 million and 27% to \$80.8 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decreases in advertising and market development were due largely to the planned decrease in advertising expenditures as part of our expense reduction initiatives.

Clearing and Servicing

Clearing and servicing was flat at \$30.9 million and decreased 5% to \$93.6 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. During the three and nine months ended September 30, 2013, servicing fees decreased as a result of lower loan balances compared to the same periods in 2012. The decrease in servicing fees for the three months ended September 30, 2013 was offset by increased clearing fees as a result of improvement in DARTs, when compared to the same period in 2012.

FDIC Insurance Premiums

FDIC insurance premiums decreased 21% to \$24.7 million and 9% to \$79.1 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decreases in FDIC insurance premiums resulted primarily from continued improvement and quality of our balance sheet, improving capital ratios and overall risk profile when compared to the same periods in 2012.

Impairment of Goodwill

Impairment of goodwill was \$142.4 million for nine months ended September 30, 2013. This impairment, incurred at the end of the second quarter of 2013, represents the entire amount of goodwill associated with our market making business. For more information on the impairment analysis related to the market making business, refer to the Summary of Critical Accounting Policies and Estimates on page 40.

Facility Restructuring and Other Exit Activities

Facility restructuring and other exit activities were \$6.4 million and \$23.9 million for the three and nine months ended September 30, 2013, respectively. These costs were driven primarily by severance costs incurred as part of our expense reduction initiatives, in addition to costs incurred in the third quarter of 2013 related to our decision to exit the market making business.

Other Operating Expenses

Other operating expenses decreased 5% to \$16.0 million and 14% to \$40.3 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decreases during the three and nine months ended September 30, 2013 were driven primarily by lower real estate owned ("REO") expenses compared to the same periods in 2012.

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Other Income (Expense)

Other income (expense) decreased 70% to \$28.7 million and 56% to \$80.7 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 as shown in the following table (dollars in millions):

| | Three Months Ended | | Variance | | Nine Months Ended | | Variance | |
|--|--------------------|-----------|---------------|-------|-------------------|------------|---------------|-------|
| | September 30, | | 2013 vs. 2012 | | September 30, | | 2013 vs. 2012 | |
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Corporate interest expense | \$ (28.6) | \$ (45.5) | \$ 16.9 | (37)% | \$ (85.8) | \$ (135.9) | \$ 50.1 | (37)% |
| Losses on early extinguishment of debt | — | (50.6) | 50.6 | * | — | (50.6) | 50.6 | * |
| Equity in income (loss) of investments and other | (0.1) | (0.2) | 0.1 | (38)% | 5.1 | 1.8 | 3.3 | 186% |
| Total other income (expense) | \$ (28.7) | \$ (96.3) | \$ 67.6 | (70)% | \$ (80.7) | \$ (184.7) | \$ 104.0 | (56)% |

Total other income (expense) included corporate interest expense on interest-bearing corporate debt for the three and nine months ended September 30, 2013 and 2012. Corporate interest expense decreased 37% to \$28.6 million and \$85.8 million for both the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 as a result of the refinance of \$1.3 billion of higher coupon corporate debt during the fourth quarter of 2012. During the nine months ended September 30, 2013, corporate interest expense was partially offset by a gain of \$5.1 million, included in equity in income of investments and other related to an investment in a venture fund.

In addition, for the three and nine months ended September 30, 2012, \$50.6 million in losses on early extinguishment of debt were recorded, driven primarily by the early extinguishment of approximately \$520 million in wholesale borrowings during the third quarter of 2012.

Income Tax Expense (Benefit)

For the three months ended September 30, 2013, income tax expense (benefit) and the effective tax rate were \$32.5 million and 40.7%, compared to \$(7.7) million and 21.1%, respectively for the same period in 2012. For the nine months ended September 30, 2013, income tax expense and the effective tax rate were \$61.4 million and 68.6%, compared to \$16.8 million and 18.6%, respectively for the same period in 2012.

At the end of June 2013, we decided to exit the market making business, and as a result recorded \$142.4 million in goodwill impairment during the nine months ended September 30, 2013. The \$142.4 million goodwill impairment charge associated with the market making business was non-deductible for tax purposes. In addition, the overall state apportionment increased significantly as a result of the exit of the market making business and we expect our state taxable income to increase in future periods. We now expect to utilize net operating losses in California; therefore we recognized a tax benefit of \$26.4 million during the nine months ended September 30, 2013, the majority of which consists of releasing valuation allowances for net operating losses, research and development credits and revaluation of other deferred tax assets relating to California. Without the exit of the market making business, our effective tax rate for the nine months ended September 30, 2013 would have been 37.8%, calculated in the following table (dollars in thousands):

| | For the Nine Months Ended | | |
|--|---------------------------|--------------------------|----------|
| | September 30, 2013 | | |
| | Pre-tax Income | Tax Expense (Benefit) | Tax Rate |
| Taxes and tax rate before impact of exit of market making business | \$ 231,939 | \$ 87,755 | 37.8% |
| Impact of exit of market making business: | | | |
| Goodwill impairment charge | (142,423) | — | |
| State apportionment change | — | (26,388) | |
| Income taxes and tax rate as reported | \$ 89,516 | \$ 61,367 | 68.6% |

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

Valuation Allowance

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

We did not establish any valuation allowance against federal deferred tax assets as of September 30, 2013 as we believe that it is more likely than not that all of these assets will be realized. We continue to maintain a valuation allowance for certain of our state, foreign country and charitable contribution deferred tax assets as it is more likely than not that they will not be realized.

SEGMENT RESULTS REVIEW

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

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Trading and Investing

The following table summarizes trading and investing financial information and key customer activity metrics as of and for the three and nine months ended September 30, 2013 and 2012 (dollars in millions, except for key metrics):

| | Three Months Ended | | Variance | | Nine Months Ended | | Variance | |
|-------------------------------|--------------------|----------|---------------|-------|-------------------|----------|---------------|-------|
| | September 30, | | 2013 vs. 2012 | | September 30, | | 2013 vs. 2012 | |
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Net operating interest income | \$ 133.4 | \$ 156.8 | \$ (23.4) | (15)% | \$ 400.7 | \$ 492.4 | \$ (91.7) | (19)% |
| Commissions | 102.8 | 90.4 | 12.4 | 14% | 309.8 | 291.2 | 18.6 | 6% |
| Fees and service charges | 39.4 | 30.3 | 9.1 | 30% | 111.4 | 89.7 | 21.7 | 24% |
| Principal transactions | 12.6 | 22.1 | (9.5) | (43)% | 55.6 | 67.5 | (11.9) | (18)% |
| Other revenues | 7.9 | 7.8 | 0.1 | 2% | 23.9 | 24.4 | (0.5) | (3)% |
| Total net revenue | 296.1 | 307.4 | (11.3) | (4)% | 901.4 | 965.2 | (63.8) | (7)% |
| Total operating expense | 170.3 | 180.4 | (10.1) | (6)% | 687.4 | 580.1 | 107.3 | 18% |
| Trading and investing income | \$ 125.8 | \$ 127.0 | \$ (1.2) | (1)% | \$ 214.0 | \$ 385.1 | \$ (171.1) | (44)% |

Key Customer Activity Metrics:

| | | | | | | | | |
|--|-----------|-----------|-----------|-------|-----------|-----------|----------|-------|
| DARTs | 145,150 | 128,701 | 16,449 | 13% | 147,777 | 141,399 | 6,378 | 5% |
| Average commission per trade | \$ 11.15 | \$ 11.24 | \$ (0.09) | (1)% | \$ 11.18 | \$ 10.98 | \$ 0.20 | 2% |
| Margin receivables (dollars in billions) | \$ 6.2 | \$ 5.6 | \$ 0.6 | 11% | \$ 6.2 | \$ 5.6 | \$ 0.6 | 11% |
| End of period brokerage accounts | 2,975,842 | 2,892,852 | 82,990 | 3% | 2,975,842 | 2,892,852 | 82,990 | 3% |
| Net new brokerage accounts | 13,111 | 18,247 | (5,136) | (28)% | 72,651 | 109,840 | (37,189) | (34)% |
| Annualized brokerage account attrition rate | 9.0% | 8.5% | 0.5% | * | 8.7% | 8.7% | 0.0% | * |
| Customer assets (dollars in billions) | \$ 240.6 | \$ 204.1 | \$ 36.5 | 18% | \$ 240.6 | \$ 204.1 | \$ 36.5 | 18% |
| Net new brokerage assets (dollars in billions) | \$ 2.4 | \$ 1.9 | \$ 0.5 | 26% | \$ 7.2 | \$ 8.1 | \$ (0.9) | (11)% |
| Brokerage related cash (dollars in billions) | \$ 38.2 | \$ 32.6 | \$ 5.6 | 17% | \$ 38.2 | \$ 32.6 | \$ 5.6 | 17% |

* Percentage not meaningful.

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

Trading and investing income decreased 1% to \$125.8 million and 44% to \$214.0 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decrease for the nine months ended September 30, 2013 was driven primarily by \$142.4 million of goodwill impairment recorded in the second quarter of 2013 related to the decision to exit the market making business. We continued to generate net new brokerage accounts, ending the third quarter of 2013 with 3.0 million accounts.

Trading and investing commissions increased 14% to \$102.8 million and 6% to \$309.8 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. This increase in commissions was primarily the result of an increase in DARTs of 13% to 145,150 and 5% to 147,777 for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012.

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Trading and investing fees and service charges increased 30% to \$39.4 million and 24% to \$111.4 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The increases in fees and service charges were driven primarily by increases in order flow revenue due to increased trading activity, as well as increases in advisor management fees driven from an increase in our retirement, investing and savings products, which were \$2.1 billion as of September 30, 2013, compared to \$1.1 billion as of September 30, 2012. Currently the market making business, G1X, has a formal intercompany agreement with ETS, both wholly owned consolidated subsidiaries of the Company. As part of the intercompany agreement, ETS routes a portion of its order flow to G1X and receives an order flow rebate which is eliminated in consolidation. After closing the sale of the market making business, we expect to see an increase in order flow revenue as ETS will be routing all of its order flow to third parties.

Trading and investing principal transactions decreased 43% to \$12.6 million and 18% to \$55.6 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decreases in principal transactions revenue were driven primarily by lower levels of shares traded and of market volatility in the three and nine months ended September 30, 2013, when compared to the same periods in 2012. The market making business generates all of our principal transactions revenue. On October 23, 2013, we entered into a definitive agreement to sell the market making business to an affiliate of Susquehanna. Upon closing of the sale, we will no longer have principal transactions revenue.

Trading and investing operating expense decreased 6% to \$170.3 million and increased 18% to \$687.4 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decrease for the three months ended September 30, 2013 resulted primarily from the planned decrease in advertising expenditures as part of our expense reduction initiatives, when compared to the same period in 2012. The increase for the nine months ended September 30, 2013 was driven by impairment of goodwill of \$142.4 million in the second quarter of 2013.

As of September 30, 2013, we had approximately 3.0 million brokerage accounts, 1.2 million stock plan accounts and 0.4 million banking accounts. For the three months ended September 30, 2013 and 2012, our brokerage products contributed 78% and 71%, respectively, and our banking products contributed 22% and 29%, respectively, of total trading and investing revenue. For the nine months ended September 30, 2013 and 2012, our brokerage products contributed 78% and 70%, respectively, and our banking products contributed 22% and 30%, respectively, of total trading and investing revenue.

Balance Sheet Management

The following table summarizes balance sheet management financial information and key financial metrics as of and for the three and nine months ended September 30, 2013 and 2012 (dollars in millions):

| | Three Months Ended | | Variance | | Nine Months Ended | | Variance | |
|------------------------------------|--------------------|-----------|---------------|-------|-------------------|----------|---------------|-------|
| | September 30, | | 2013 vs. 2012 | | September 30, | | 2013 vs. 2012 | |
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Net operating interest income | \$ 107.5 | \$ 104.1 | \$ 3.4 | 3% | \$ 324.0 | \$ 332.4 | \$ (8.4) | (3)% |
| Fees and service charges | 0.5 | 0.6 | (0.1) | (25)% | 1.4 | 2.3 | (0.9) | (37)% |
| Gains on loans and securities, net | 12.2 | 79.0 | (66.8) | (85)% | 49.0 | 138.8 | (89.8) | (65)% |
| Net impairment | (0.6) | (2.4) | 1.8 | (76)% | (2.3) | (11.2) | 8.9 | (79)% |
| Other revenues | 1.1 | 1.3 | (0.2) | (13)% | 3.1 | 4.3 | (1.2) | (28)% |
| Total net revenue | 120.7 | 182.6 | (61.9) | (34)% | 375.2 | 466.6 | (91.4) | (20)% |
| Provision for loan losses | 37.4 | 141.0 | (103.6) | (73)% | 126.2 | 280.2 | (154.0) | (55)% |
| Total operating expense | 43.5 | 53.2 | (9.7) | (18)% | 135.0 | 168.4 | (33.4) | (20)% |
| Balance sheet management income | \$ 39.8 | \$ (11.6) | \$ 51.4 | * | \$ 114.0 | \$ 18.0 | \$ 96.0 | 534% |

* Percentage not meaningful.

Key Financial Metrics:

| | | | | | | | | |
|------------------------------------|---------|---------|----------|-------|---------|---------|----------|-------|
| Special mention loan delinquencies | \$278.1 | \$327.4 | \$(49.3) | (15)% | \$278.1 | \$327.4 | \$(49.3) | (15)% |
| Allowance for loan losses | \$458.9 | \$508.3 | \$(49.4) | (10)% | \$458.9 | \$508.3 | \$(49.4) | (10)% |

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

Balance sheet management reported income of \$39.8 million and \$114.0 million for the three and nine months ended September 30, 2013, respectively, compared to a loss of \$11.6 million and income of \$18.0 million for the same periods in 2012, due primarily to decreases in provision for loan losses partially offset by decreases in gains on loans and securities net.

Gains on loans and securities, net were \$12.2 million and \$49.0 million for the three and nine months ended September 30, 2013, respectively, compared to \$79.0 million and \$138.8 million for the same periods in 2012. The decreases in gains on loans and securities net for the three and nine months ended September 30, 2013, were driven by additional gains recognized in the prior periods from the sale of available-for-sale securities as a result of our deleveraging efforts, primarily related to a reduction in wholesale funding obligations.

We recognized \$0.6 million and \$2.3 million of net impairment during the three and nine months ended September 30, 2013, compared to \$2.4 million and \$11.2 million, respectively for the same periods in 2012 on certain securities in the non-agency CMO portfolio due to continued deterioration in the expected credit performance of the underlying loans in those specific securities.

Provision for loan losses decreased 73% to \$37.4 million and 55% to \$126.2 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decrease in provision for loan losses was driven primarily by improving credit trends and loan portfolio run-off.

During the three and nine months ended September 30, 2013, we evaluated and refined our default assumptions related to a subset of the home equity line of credit portfolio that will require borrowers to repay the loan in full at the end of the draw period, commonly referred to as “balloon loans”. These loans were approximately \$250 million of the home equity line of credit portfolio at September 30, 2013. We evaluated the significant burden a balloon payment may place on a borrower with a low Fair Isaac Credit Organization (“FICO”) score and high combined loan-to-value (“CLTV”) ratio, and examined those loans within the balloon portfolio. We refined our expectations and estimates around the time period that it might take for these borrowers’ equity positions in their collateral to appreciate in order to allow for possible refinancing of the balloon loan at maturity. As a result of this evaluation, we increased our default assumptions and extended the period of management’s forecasted loan losses captured within the general allowance to include the total probable loss on this subset of balloon loans. The overall impact of these enhancements drove the majority of provision for loan losses during the three and nine months ended September 30, 2013.

During the three and nine months ended September 30, 2012, provision for loan losses included approximately \$50 million in charge-offs associated with newly identified bankruptcy filings, with approximately 80% related to prior years. We utilize third party loan servicers to obtain bankruptcy data on our borrowers and during the third quarter of 2012, we identified an increase in bankruptcies reported by one specific servicer. In researching this increase, we discovered that the servicer had not been reporting historical bankruptcy data on a timely basis. As a result, we implemented an enhanced procedure around all servicer reporting to

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corroborate bankruptcy reporting with independent third party data. Through this additional process, approximately \$90 million of loans were identified in which servicers failed to report the bankruptcy filing to us, approximately 90% of which were current at September 30, 2012. As a result, these loans were written down to the estimated current value of the underlying property less estimated selling costs, or approximately \$40 million, during the third quarter of 2012. These charge-offs resulted in an increase to the provision for loan losses of \$50 million for the three months ended September 30, 2012.

Total balance sheet management operating expense decreased 18% to \$43.5 million and 20% to \$135.0 million for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The decreases in operating expense resulted primarily from lower FDIC insurance premiums, reduced servicing expenses due to lower loan balances and reduced expenses related to REO when compared to the same periods in 2012.

Corporate/Other

The following table summarizes corporate/other financial information for the three and nine months ended September 30, 2013 and 2012 (dollars in millions):

| | Three Months Ended September 30, | | Variance 2013 vs. 2012 | | Nine Months Ended September 30, | | Variance 2013 vs. 2012 | |
|--|-------------------------------------|------------|---------------------------|-------|------------------------------------|------------|---------------------------|-------|
| | 2013 | 2012 | Amount | % | 2013 | 2012 | Amount | % |
| Total net revenue | \$ — | \$ — | \$ — | * | \$ — | \$ — | \$ — | * |
| Compensation and benefits | 24.8 | 28.3 | (3.5) | (13)% | 67.8 | 63.1 | 4.7 | 7% |
| Professional services | 12.7 | 12.9 | (0.2) | (1)% | 31.2 | 28.1 | 3.1 | 11% |
| Occupancy and equipment | 1.9 | 1.6 | 0.3 | 21% | 4.7 | 3.8 | 0.9 | 24% |
| Communications | 0.4 | 0.5 | (0.1) | 5% | 1.2 | 1.3 | (0.1) | (3)% |
| Depreciation and amortization | 4.4 | 3.9 | 0.5 | 11% | 12.5 | 12.2 | 0.3 | 2% |
| Facility restructuring and other exit activities | 6.4 | 2.3 | 4.1 | * | 23.9 | 3.5 | 20.4 | * |
| Other operating expenses | 6.3 | 5.9 | 0.4 | 7% | 16.5 | 16.2 | 0.3 | 2% |
| Total operating expense | 56.9 | 55.4 | 1.5 | 3% | 157.8 | 128.2 | 29.6 | 23% |
| Operating loss | (56.9) | (55.4) | (1.5) | 3% | (157.8) | (128.2) | (29.6) | 23% |
| Total other income (expense) | (28.7) | (96.3) | 67.6 | (70)% | (80.7) | (184.7) | 104.0 | (56)% |
| Corporate/other loss | \$ (85.6) | \$ (151.7) | \$ 66.1 | (44)% | \$ (238.5) | \$ (312.9) | \$ 74.4 | (24)% |

* 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 \$85.6 million and \$238.5 million for the three and nine months ended September 30, 2013, respectively, compared to \$151.7 million and \$312.9 million for the same periods in 2012.

The operating loss increased 3% to \$56.9 million and 23% to \$157.8 million for the three and nine months ended September 30, 2013, respectively, when compared to the same period in 2012, due primarily to increases in facility restructuring and other exit activities expense as a result of severance costs incurred as part of our expense reduction initiatives, in addition to costs incurred in the third quarter of 2013 related to our decision to exit the market making business.

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Total other income (expense) included corporate interest expense on interest-bearing corporate debt for the three and nine months ended September 30, 2013 and 2012. Corporate interest expense decreased 37% to \$28.6 million and \$85.8 million for both the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 as a result of the refinance of \$1.3 billion of higher coupon corporate debt during the fourth quarter of 2012. During the nine months ended September 30, 2013, corporate interest expense was partially offset by a gain of \$5.1 million included in equity in income of investments and other related to an investment in a venture fund.

In addition, for the three and nine months ended September 30, 2012, \$50.6 million in losses on early extinguishment of debt were recorded, driven primarily by the early extinguishment of approximately \$520 million in wholesale borrowings during the third quarter of 2012.

BALANCE SHEET OVERVIEW

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

| | September 30, 2013 | December 31, 2012 | Variance 2013 vs. 2012 | |
|--|--------------------------|-------------------------|---------------------------|-------------|
| | | | Amount | % |
| Assets: | | | | |
| Cash and equivalents | \$ 1,796.2 | \$ 2,761.5 | \$ (965.3) | (35)% |
| Segregated cash | 738.2 | 376.9 | 361.3 | 96% |
| Securities ⁽¹⁾ | 23,225.6 | 23,084.2 | 141.4 | 1% |
| Margin receivables | 6,188.7 | 5,804.0 | 384.7 | 7% |
| Loans receivable, net | 8,564.6 | 10,098.7 | (1,534.1) | (15)% |
| Investment in FHLB stock | 61.4 | 67.4 | (6.0) | (9)% |
| Other ⁽²⁾ | 4,972.8 | 5,194.0 | (221.2) | (4)% |
| Total assets | <u>\$45,547.5</u> | <u>\$47,386.7</u> | <u>\$(1,839.2)</u> | <u>(4)%</u> |
| Liabilities and shareholders' equity: | | | | |
| Deposits | \$25,869.8 | \$28,392.5 | \$(2,522.7) | (9)% |
| Wholesale borrowings ⁽³⁾ | 5,734.7 | 5,715.6 | 19.1 | 0% |
| Customer payables | 5,830.3 | 4,964.9 | 865.4 | 17% |
| Corporate debt | 1,767.7 | 1,765.0 | 2.7 | 0% |
| Other liabilities | 1,515.4 | 1,644.2 | (128.8) | (8)% |
| Total liabilities | 40,717.9 | 42,482.2 | (1,764.3) | (4)% |
| Shareholders' equity | 4,829.6 | 4,904.5 | (74.9) | (2)% |
| Total liabilities and shareholders' equity | <u>\$45,547.5</u> | <u>\$47,386.7</u> | <u>\$(1,839.2)</u> | <u>(4)%</u> |

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

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

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

Segregated Cash

Segregated cash increased by \$361.3 million to \$738.2 million during the nine months ended September 30, 2013. The level of cash required to be segregated under federal or other regulations, or segregated cash, is driven largely by customer cash and securities lending balances we hold as a liability in excess of the amount of margin receivables and securities borrowed balances we hold as an asset. The excess represents customer cash that we are required by our regulators to segregate for the exclusive benefit of our brokerage customers.

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Securities

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

| | September 30, 2013 | December 31, 2012 | Variance 2013 vs. 2012 | |
|--|--------------------------|-------------------------|---------------------------|--------|
| | | | Amount | % |
| Trading securities | \$ — | \$ 101.3 | \$(101.3) | (100)% |
| Available-for-sale securities: | | | | |
| Residential mortgage-backed securities: | | | | |
| Agency mortgage-backed securities and CMOs | \$12,222.6 | \$12,097.2 | \$ 125.4 | 1% |
| Non-agency CMOs | 14.0 | 235.2 | (221.2) | (94)% |
| Total residential mortgage-backed securities | 12,236.6 | 12,332.4 | (95.8) | (1)% |
| Investment securities | 1,044.9 | 1,110.6 | (65.7) | (6)% |
| Total available-for-sale securities | \$13,281.5 | \$13,443.0 | \$(161.5) | (1)% |
| Held-to-maturity securities: | | | | |
| Residential mortgage-backed securities: | | | | |
| Agency mortgage-backed securities and CMOs | \$ 8,255.4 | \$ 7,887.5 | \$ 367.9 | 5% |
| Investment securities | 1,688.7 | 1,652.4 | 36.3 | 2% |
| Total held-to-maturity securities | \$ 9,944.1 | \$ 9,539.9 | \$ 404.2 | 4% |
| Total securities | \$23,225.6 | \$23,084.2 | \$ 141.4 | 1% |

Securities represented 51% and 49% of total assets at September 30, 2013 and December 31, 2012, respectively. The decline in available-for-sale securities during the nine months ended September 30, 2013 was due primarily to a decrease of \$221.2 million in non-agency CMOs. We sold \$230.5 million in amortized cost of available-for-sale non-agency CMOs during the first quarter of 2013 as part of our focus to reduce risk and deleverage the balance sheet.

The decrease in trading securities during the nine months ended September 30, 2013, was due to our decision at the end of the second quarter of 2013 to exit the market making business. All assets related to the market making business, including all of the trading securities, were reclassified to held-for-sale assets, which are reflected in the other assets line item on the consolidated balance sheet.

Loans Receivable, Net

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

| | September 30, 2013 | December 31, 2012 | Variance 2013 vs. 2012 | |
|-----------------------------|--------------------------|-------------------------|---------------------------|-------|
| | | | Amount | % |
| One- to four-family | \$4,713.0 | \$ 5,442.2 | \$ (729.2) | (13)% |
| Home equity | 3,619.0 | 4,223.4 | (604.4) | (14)% |
| Consumer and other | 641.1 | 844.9 | (203.8) | (24)% |
| Unamortized premiums, net | 50.4 | 68.9 | (18.5) | (27)% |
| Allowance for loan losses | (458.9) | (480.7) | 21.8 | (5)% |
| Total loans receivable, net | \$8,564.6 | \$10,098.7 | \$(1,534.1) | (15)% |

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Loans receivable, net decreased 15% to \$8.6 billion at September 30, 2013 from \$10.1 billion at December 31, 2012. This decline was due primarily to our strategy of reducing balance sheet risk by allowing the loan portfolio to pay down, which we plan to do for the foreseeable future.

Other Assets

The other assets balance is summarized as follows (dollars in millions):

| | September 30, 2013 | December 31, 2012 | Variance 2013 vs. 2012 | |
|-----------------------------|--------------------------|-------------------------|---------------------------|-------------|
| | | | Amount | % |
| Property and equipment, net | \$ 246.2 | \$ 288.2 | \$ (42.0) | (15)% |
| Goodwill | 1,791.8 | 1,934.2 | (142.4) | (7)% |
| Other intangibles, net | 221.6 | 260.6 | (39.0) | (15)% |
| Other assets | 2,713.2 | 2,711.0 | 2.2 | 0% |
| Total other assets | <u>\$4,972.8</u> | <u>\$5,194.0</u> | <u>\$ (221.2)</u> | <u>(4)%</u> |

Total other assets decreased 4% to \$5.0 billion at September 30, 2013, from \$5.2 billion at December 31, 2012, due primarily to a decrease in goodwill. At the end of the second quarter of 2013, we decided to exit the market making business, and as a result the entire amount of the associated goodwill of \$142.4 million was impaired. Additionally, the assets related to the market making business were transferred to held-for-sale assets. Held-for-sale assets, which are reported in the other assets line item on the consolidated balance sheet, consisted of \$97.5 million of trading securities and \$21.2 million of other intangibles, net at September 30, 2013.

Deposits

Deposits are summarized as follows (dollars in millions):

| | September 30, 2013 | December 31, 2012 | Variance 2013 vs. 2012 | |
|---|--------------------------|-------------------------|---------------------------|-------------|
| | | | Amount | % |
| Sweep deposits | \$19,453.2 | \$21,253.6 | \$(1,800.4) | (8)% |
| Complete savings deposits | 4,407.3 | 4,981.6 | (574.3) | (12)% |
| Checking deposits | 1,022.8 | 1,055.4 | (32.6) | (3)% |
| Other money market and savings deposits | 918.6 | 995.2 | (76.6) | (8)% |
| Time deposits | 67.9 | 106.7 | (38.8) | (36)% |
| Total deposits | <u>\$25,869.8</u> | <u>\$28,392.5</u> | <u>\$(2,522.7)</u> | <u>(9)%</u> |

Deposits represented 64% and 67% of total liabilities at September 30, 2013 and December 31, 2012, respectively. At September 30, 2013, 91% of our customer deposits were covered by FDIC insurance. Deposits provide the benefit of lower interest costs compared with wholesale funding alternatives. Deposits decreased 9% to \$25.9 billion at September 30, 2013 from \$28.4 billion at December 31, 2012, driven primarily by \$3.2 billion in sweep deposits that were transferred off balance sheet to third parties during the first nine months of 2013 as part of our deleveraging initiatives.

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The majority of the deposits balance, specifically sweep deposits, is included in brokerage related cash and reported as a customer activity metric of \$38.2 billion and \$33.9 billion at September 30, 2013 and December 31, 2012, respectively. The total brokerage related cash balance is summarized as follows (dollars in millions):

| | September 30, 2013 | December 31, 2012 | Variance 2013 vs. 2012 | |
|--|--------------------------|-------------------------|---------------------------|------------|
| | | | Amount | % |
| Deposits | \$25,869.8 | \$28,392.5 | \$(2,522.7) | (9)% |
| Less: bank related cash ⁽¹⁾ | (6,416.6) | (7,138.9) | 722.3 | (10)% |
| Customer payables | 5,830.3 | 4,964.9 | 865.4 | 17% |
| Customer assets held by third parties ⁽²⁾ | 12,916.1 | 7,644.2 | 5,271.9 | 69% |
| Total brokerage related cash | \$38,199.6 | \$33,862.7 | \$ 4,336.9 | 13% |

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

(2) Customer assets held by third parties are not reflected on our consolidated balance sheet.

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

As part of our strategy to strengthen our overall financial and franchise position we have been focused on improving our capital ratios by reducing risk and deleveraging the balance sheet. Our deleveraging strategy included transferring customer deposits to third party institutions. At September 30, 2013, our customers held \$12.9 billion of assets at third party institutions, including third party banks and money market funds. Approximately 67% of these off-balance sheet assets are as a result of our deleveraging efforts. Customer assets held by third parties included \$4.3 billion and \$2.3 billion of customer sweep deposits at September 30, 2013 and December 31, 2012, respectively in the extended insurance sweep deposit account program (“ESDA”) that we have in place for brokerage customers. At September 30, 2013, the ESDA program utilized E*TRADE Bank in combination with six 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. In addition, at September 30, 2013 and December 31, 2012 customer assets held by third parties included \$8.6 billion and \$5.3 billion, respectively, held in third party money market funds in which our customers can elect to participate.

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):

| | September 30, 2013 | December 31, 2012 | Variance 2013 vs. 2012 | |
|---|--------------------------|-------------------------|---------------------------|-----------|
| | | | Amount | % |
| Securities sold under agreements to repurchase | \$4,449.7 | \$4,454.7 | \$ (5.0) | (0)% |
| FHLB advances | \$ 846.0 | \$ 831.7 | \$ 14.3 | 2% |
| Subordinated debentures | 427.8 | 427.7 | 0.1 | 0% |
| Other | 11.2 | 1.5 | 9.7 | * |
| Total FHLB advances and other borrowings | \$1,285.0 | \$1,260.9 | \$ 24.1 | 2% |
| Total wholesale borrowings | \$5,734.7 | \$5,715.6 | \$ 19.1 | 0% |

* Percentage not meaningful.

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Wholesale borrowings represented 14% and 13% of total liabilities at September 30, 2013 and December 31, 2012, respectively. Securities sold under agreements to repurchase and FHLB advances are the primary wholesale funding sources of the Bank. As a result, we expect these balances to fluctuate over time as deposits and interest-earning assets fluctuate.

Corporate Debt

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

| | <u>Face Value</u> | <u>Discount</u> | <u>Net</u> |
|-------------------------------------|-------------------|------------------|------------------|
| September 30, 2013 | | | |
| Interest-bearing notes: | | | |
| 6 3/4% Notes, due 2016 | \$ 435.0 | \$ (4.5) | \$ 430.5 |
| 6% Notes, due 2017 | 505.0 | (3.9) | 501.1 |
| 6 3/8% Notes, due 2019 | 800.0 | (6.6) | 793.4 |
| Total interest-bearing notes | 1,740.0 | (15.0) | 1,725.0 |
| Non-interest-bearing debt: | | | |
| 0% Convertible debentures, due 2019 | 42.7 | — | 42.7 |
| Total corporate debt | <u>\$1,782.7</u> | <u>\$ (15.0)</u> | <u>\$1,767.7</u> |
| December 31, 2012 | | | |
| Interest-bearing notes: | | | |
| 6 3/4% Notes, due 2016 | \$ 435.0 | \$ (5.8) | \$ 429.2 |
| 6% Notes, due 2017 | 505.0 | (4.6) | 500.4 |
| 6 3/8% Notes, due 2019 | 800.0 | (7.3) | 792.7 |
| Total interest-bearing notes | 1,740.0 | (17.7) | 1,722.3 |
| Non-interest-bearing debt: | | | |
| 0% Convertible debentures, due 2019 | 42.7 | — | 42.7 |
| Total corporate debt | <u>\$1,782.7</u> | <u>\$ (17.7)</u> | <u>\$1,765.0</u> |

Shareholders' Equity

The activity in shareholders' equity during the nine months ended September 30, 2013 is summarized as follows (dollars in millions):

| | <u>Common Stock / Additional Paid- In Capital</u> | <u>Accumulated Deficit / Other Comprehensive Loss</u> | <u>Total</u> |
|---|---|---|------------------|
| Beginning balance, December 31, 2012 | \$ 7,322.1 | \$ (2,417.6) | \$4,904.5 |
| Net income | — | 28.1 | 28.1 |
| Net change from available-for-sale securities | — | (231.7) | (231.7) |
| Net change from cash flow hedging instruments | — | 120.9 | 120.9 |
| Other ⁽¹⁾ | 7.7 | 0.1 | 7.8 |
| Ending balance, September 30, 2013 | <u>\$ 7,329.8</u> | <u>\$ (2,500.2)</u> | <u>\$4,829.6</u> |

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

LIQUIDITY AND CAPITAL RESOURCES

We have established liquidity and capital policies to support the successful execution of our business strategies, while ensuring ongoing and sufficient liquidity through the business cycle. We believe liquidity is of critical importance to the Company and especially important within E*TRADE Bank. The objective of our policies is to ensure that we can meet our corporate and banking liquidity needs under both normal operating conditions and under periods of stress in the financial markets.

Our corporate liquidity needs are primarily driven by the amount of principal and interest due on our corporate debt as well as any capital needs at E*TRADE Bank. Our banking liquidity needs are driven primarily by the level and volatility of our customer deposits. Management maintains an extensive set of liquidity sources and monitors certain business trends and market metrics closely in an effort to ensure we have sufficient liquidity and to avoid dependence on other more expensive sources of funding.

Management believes the following sources of liquidity are of critical importance in maintaining ample funding for liquidity needs: Corporate cash, Bank cash, deposits and unused FHLB borrowing capacity. Management believes that within deposits, sweep deposits are of particular importance as they are the most stable source of liquidity for E*TRADE Bank when compared to non-sweep deposits. While in recent periods we have transferred customer sweep deposits to third party banks that participate in our ESDA program, we maintain the ability to bring these off-balance sheet deposits back to E*TRADE Bank with appropriate notification to the third party program banks. In addition, certain customer payables and sweep deposits were transferred to third party money market funds. At September 30, 2013, we had \$4.3 billion and \$8.6 billion of customer deposits at third party banks and third party money market funds, respectively. We continually assess our liquidity position with respect to our ESDA program with the third party banks, and maintain additional sources of liquidity outside of deposits through other programs that are available to us. Refer to "Other Sources of Liquidity" within this section for additional information on those programs.

Capital is generated primarily through the business operations of the trading and investing and balance sheet management segments, which are primarily contained within E*TRADE Bank; therefore, we believe a key indicator of the capital generated or used in our business operations is the level of regulatory capital in E*TRADE Bank. As of September 30, 2013, E*TRADE Bank's Tier 1 leverage ratio was 9.5%, an increase from 8.7% at December 31, 2012. We have been focused on improving the Tier 1 leverage ratio at E*TRADE Bank through continued earnings and deleveraging the balance sheet by a reduction in wholesale borrowings, retail deposits and customer payables. Through September 30, 2013, we have surpassed our targeted \$8.5 billion in deleveraging initiatives. While we may take some tactical actions in future periods, we consider our deleveraging initiatives to be complete. We are now focused on continuing to generate capital through earnings.

We submitted an initial long-term capital plan to the OCC and Federal Reserve during the second quarter of 2012. The plan included: our five-year business strategy; forecasts of our business results and capital ratios; capital distribution plans in current and adverse operating conditions; and internally developed stress tests. During the third quarter of 2012, we received initial feedback from our regulators on this plan and we believe that key elements of this plan, specifically reducing risk, deleveraging the balance sheet and the development of an enterprise risk management function, are critical. We submitted an updated long-term capital plan to the OCC and Federal Reserve in February 2013, which included the key elements outlined in the initial plan as well as the progress made during 2012 on those key elements. We believe we have made important progress on our long-term capital plan and believe it is evidenced by the \$100 million dividend that our regulators approved from E*TRADE Bank during the third quarter of 2013. We plan to request a similar dividend each quarter over the near term while continuing an active and ongoing dialogue with our regulators to ensure our execution of the plan is consistent with their expectations.

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Consolidated Cash and Equivalents

The consolidated cash and equivalents balance decreased by \$1.0 billion to \$1.8 billion at September 30, 2013 when compared to December 31, 2012. The majority of this balance is cash held in regulated subsidiaries, primarily the Bank, outlined as follows (dollars in millions):

| | <u>September 30, 2013</u> | <u>December 31, 2012</u> | <u>Variance 2013 vs. 2012</u> |
|---|-----------------------------------|----------------------------------|-----------------------------------|
| Corporate cash | \$ 372.9 | \$ 407.6 | \$ (34.7) |
| Bank cash | 1,401.3 | 2,319.6 | (918.3) |
| International brokerage and other cash | 22.0 | 34.3 | (12.3) |
| Total consolidated cash and equivalents | <u>\$1,796.2</u> | <u>\$2,761.5</u> | <u>\$ (965.3)</u> |

Corporate cash is the primary source of liquidity at the parent company. We define corporate cash as cash held at the parent company as well as cash held in certain subsidiaries that can distribute cash to the parent company without any regulatory approval. We believe corporate cash is a useful measure of the parent company's liquidity as it is the primary source of capital above and beyond the capital deployed in our regulated subsidiaries. Corporate cash can fluctuate in any given quarter and is impacted primarily by tax settlements, approval and timing of subsidiary dividends, debt service costs and other overhead cost sharing arrangements. Including the \$100 million dividend from E*TRADE Bank to the parent company in the third quarter of 2013, corporate cash ended at \$372.9 million. We target corporate cash to be at least two times our annual debt service, or approximately \$220 million. From the level of corporate cash at September 30, 2013, we expect this balance to grow, assuming we receive regulatory approval for future dividends. The parent company has approximately \$250 million in net deferred tax assets, which will ultimately become sources of corporate cash as the parent's subsidiaries reimburse the parent for the use of its deferred tax assets.

Liquidity Available from Subsidiaries

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

E*TRADE Bank is subject to capital requirements determined by its primary regulators. At September 30, 2013 and December 31, 2012, E*TRADE Bank had \$1.9 billion and \$1.6 billion, respectively, of Tier 1 leverage capital in excess of the regulatory minimum level required to be considered "well capitalized."

The Company's broker-dealer subsidiaries are subject to capital requirements determined by their respective regulators. At September 30, 2013 and December 31, 2012, all of our brokerage subsidiaries met their minimum net capital requirements. Our broker-dealer subsidiaries had excess net capital of \$828.6 million at September 30, 2013, an increase of \$173.5 million from \$655.1 million at December 31, 2012. The excess net capital of the broker-dealer subsidiaries at September 30, 2013 included \$566.7 million and \$214.9 million of excess net capital at E*TRADE Clearing LLC and E*TRADE Securities LLC, respectively, which are subsidiaries of E*TRADE Bank and are also included in the excess capital of E*TRADE Bank.

Financial Regulatory Reform Legislation and Basel III Framework

The Dodd-Frank Act requires all companies, including savings and loan holding companies, that directly or indirectly control an insured depository institution to serve as a source of strength for the institution. The implementation of holding company capital requirements will impact us as the parent company was not previously subject to regulatory capital requirements. These holding company capital requirements will become

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effective in 2015. We believe these capital ratios are an important measure of capital strength and accordingly manage our capital against the current capital ratios that apply to bank holding companies. The Tier 1 leverage, Tier 1 risk-based capital and total risk-based capital ratios are non-GAAP measures as the parent company is not yet held to these regulatory capital requirements and are calculated as follows (dollars in millions):

| | September 30, 2013 | December 31, 2012 | September 30, 2012 |
|---|--------------------------|-------------------------|--------------------------|
| Shareholders' equity | \$ 4,829.6 | \$ 4,904.5 | \$ 5,093.9 |
| Deduct: | | | |
| Losses in other comprehensive income on available-for-sale debt securities and cash flow hedges, net of tax | (426.2) | (315.4) | (307.6) |
| Goodwill and other intangible assets, net of deferred tax liabilities | 1,681.4 | 1,899.4 | 1,897.6 |
| Add: | | | |
| Qualifying restricted core capital elements (TRUPs) ⁽¹⁾ | 433.0 | 433.0 | 433.0 |
| Subtotal | 4,007.4 | 3,753.5 | 3,936.9 |
| Deduct: | | | |
| Disallowed servicing assets and deferred tax assets | 1,223.6 | 1,278.9 | 1,259.1 |
| Tier 1 capital | 2,783.8 | 2,474.6 | 2,677.8 |
| Add: | | | |
| Allowable allowance for loan losses | 230.9 | 251.8 | 261.6 |
| Total capital | \$ 3,014.7 | \$ 2,726.4 | \$ 2,939.4 |
| Total average assets | \$ 45,123.9 | \$ 48,152.7 | \$ 49,400.8 |
| Deduct: | | | |
| Goodwill and other intangible assets, net of deferred tax liabilities | 1,681.4 | 1,899.4 | 1,897.6 |
| Subtotal | 43,442.5 | 46,253.3 | 47,503.2 |
| Deduct: | | | |
| Disallowed servicing assets and deferred tax assets | 1,223.6 | 1,278.9 | 1,259.1 |
| Average total assets for leverage capital purposes | \$ 42,218.9 | \$ 44,974.4 | \$ 46,244.1 |
| Total risk-weighted assets ⁽²⁾ | \$ 18,199.6 | \$ 19,849.9 | \$ 20,614.9 |
| Tier 1 leverage ratio (Tier 1 capital / Average total assets for leverage capital purposes) | 6.6% | 5.5% | 5.8% |
| Tier 1 capital / Total risk-weighted assets | 15.3% | 12.5% | 13.0% |
| Total capital / Total risk-weighted assets | 16.6% | 13.7% | 14.3% |

(1) The Company included 100% of its trust preferred securities ("TRUPs") in E*TRADE Financial's Tier 1 capital, as the final ruling issued in July 2013 by the regulatory agencies has the phase-out of TRUPs beginning in 2015 for the Company. If the TRUPs phase-out had been implemented, E*TRADE Financial's Tier 1 leverage ratio would have been 5.4% at September 30, 2013.

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

As of September 30, 2013, our Tier 1 leverage ratio was approximately 6.6% compared to the minimum ratio required to be "well capitalized" of 5%, the Tier 1 risk-based capital ratio was approximately 15.3% compared to the minimum ratio required to be "well capitalized" of 6%, and the total risk-based capital ratio was approximately 16.6% compared to the minimum ratio required to be "well capitalized" of 10%.

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Our Tier 1 common ratio, which is a non-GAAP measure and currently has no mandated minimum or “well capitalized” standard, was 12.9% as of September 30, 2013. We believe this ratio is an important measure of our capital strength. The Tier 1 common ratio is defined as Tier 1 capital less elements of Tier 1 capital that are not in the form of common equity, such as trust preferred securities, divided by total risk-weighted assets. The following table shows the calculation of the Tier 1 common ratio (dollars in millions):

| | September 30, 2013 | December 31, 2012 | September 30, 2012 |
|---|-----------------------|----------------------|-----------------------|
| Shareholders' equity | \$ 4,829.6 | \$ 4,904.5 | \$ 5,093.9 |
| Deduct: | | | |
| Losses in other comprehensive income on available-for-sale debt securities and cash flow hedges, net of tax | (426.2) | (315.4) | (307.6) |
| Goodwill and other intangible assets, net of deferred tax liabilities | 1,681.4 | 1,899.4 | 1,897.6 |
| Subtotal | 3,574.4 | 3,320.5 | 3,503.9 |
| Deduct: | | | |
| Disallowed servicing assets and deferred tax assets | 1,223.6 | 1,278.9 | 1,259.1 |
| Tier 1 common | \$ 2,350.8 | \$ 2,041.6 | \$ 2,244.8 |
| Total risk-weighted assets | \$ 18,199.6 | \$ 19,849.9 | \$ 20,614.9 |
| Tier 1 common ratio (Tier 1 common / Total risk-weighted assets) | 12.9% | 10.3% | 10.9% |

In July 2013, the U.S. Federal banking agencies finalized a rule to implement Basel III in the United States, a framework for the calculation and components of a banking organization's regulatory capital and for calculating a banking organization's risk-weighted assets. We believe the most relevant elements of the final rule to us relate to the risk-weighting of mortgage loans, which will remain unchanged from current rules, and margin receivables, which will qualify for 0% risk-weighting. In addition, the final rule gives the option for a one-time permanent election for the inclusion or exclusion in the calculation of Common Tier 1 capital of unrealized gains (losses) on all available-for-sale debt securities, which we intend to elect to exclude unrealized gains (losses). We believe the incorporation of these elements will have a favorable impact on our current capital ratios. The phase-in of the adopted rules is scheduled to begin in 2015, and we will be required to comply with the fully phased-in Basel III capital standards beginning in 2019.

On October 9, 2012, the OCC and the Federal Reserve adopted final regulations implementing the requirements to conduct company-run stress tests on an annual basis. Under the OCC and the Federal Reserve stress test regulations, E*TRADE Bank and the Company, respectively, will be required to utilize stress-testing methodologies providing for results under at least three different sets of conditions, including baseline, adverse, and severely adverse conditions. The final regulations require E*TRADE Bank to conduct its first stress test using financial statement data as of September 30, 2013, and it will be required to report results to the OCC on or before March 31, 2014. The final regulations will apply to the Company in the fall of 2016.

We conducted a company-run stress test for E*TRADE Bank and the Company, which we believe is consistent with the OCC's and Federal Reserve's methodologies, respectively, and provided the results to the OCC and the Federal Reserve with the submission of the long-term capital plan in February 2013.

On October 24, 2013, U.S. Federal banking agencies issued an inter-agency notice of proposed rulemaking that would implement a quantitative liquidity requirement generally consistent with the liquidity coverage ratio standard established by Basel III. We are currently assessing the impact of the proposed rule, which is subject to comment until January 31, 2014 and to further modification.

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Other Sources of Liquidity

We also maintain uncommitted lines of credit with unaffiliated banks to finance margin lending, with available balances subject to approval when utilized. At September 30, 2013, there were no outstanding balances.

We rely on borrowed funds, from sources such as securities sold under agreements to repurchase and FHLB advances, to provide liquidity for E*TRADE Bank. Our ability to borrow these funds is dependent upon the continued availability of funding in the wholesale borrowings market. In addition, we can borrow from the Federal Reserve Bank's discount window to meet short-term liquidity requirements, although it is not viewed as a primary source of funding. At September 30, 2013, E*TRADE Bank had approximately \$3.1 billion and \$0.9 billion in additional collateralized borrowing capacity with the FHLB and the Federal Reserve Bank, respectively. We also have the ability to generate liquidity in the form of additional deposits by raising the yield on our customer deposit account products.

Off-Balance Sheet Arrangements

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

RISK MANAGEMENT

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

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

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

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- *Legal, Regulatory and Compliance Risk*—the current and prospective risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, internal policies, and procedures, or ethical standards.

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

Credit Risk Management

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

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

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

Loss Mitigation on the Loan Portfolio

We have a credit risk operations team that focuses on the mitigation of potential losses in the loan portfolio. Through a variety of strategies, including voluntary line closures, automatically freezing lines on all delinquent accounts, and freezing lines on loans with materially reduced home equity, we have reduced our exposure to open home equity lines from a high of over \$7 billion in 2007 to \$251.7 million as of September 30, 2013.

We have an initiative to assess our servicing relationships and, where appropriate, transfer certain mortgage loans to servicers that specialize in managing troubled assets. We believe this initiative has improved and will continue to improve the credit performance of the loans transferred in future periods when compared to the expected credit performance of these same loans if they had not been transferred. We completed a servicer transfer of \$1.6 billion of mortgage loans during the second quarter of 2013, which resulted in a total of \$3.5 billion of our mortgage loans held at servicers that specialize in managing troubled assets at September 30, 2013.

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We have a loan modification program that focuses on the mitigation of potential losses in the loan portfolio. We consider modifications in which we make an economic concession to a borrower experiencing financial difficulty a TDR. During the nine months ended September 30, 2013, we modified \$72.0 million and \$13.7 million of one- to four-family and home equity loans, respectively, in which the modification was considered a TDR.

We also processed minor modifications on a number of loans through traditional collections actions taken in the normal course of servicing delinquent accounts. These actions typically result in an insignificant delay in the timing of payments; therefore, we do not consider such activities to be economic concessions to the borrowers. As of September 30, 2013 and December 31, 2012, we had \$33.2 million and \$33.4 million of mortgage loans, respectively, in which the modification was not considered a TDR due to the insignificant delay in the timing of payments. Approximately 5% and 8% of these loans were classified as nonperforming as of September 30, 2013 and December 31, 2012, respectively.

We continue to review the mortgage loan portfolio in order to identify loans to be repurchased by the originator. Our review is primarily focused on identifying loans with violations of transaction representations and warranties or material misrepresentation on the part of the seller. Any loans identified with these deficiencies are submitted to the original seller for repurchase. During the nine months ended September 30, 2013 and 2012, we agreed to settlements with third party mortgage originators specific to loans sold to us by this originator. One-time payments were agreed upon to satisfy in full all pending and future repurchase requests with this specific originator. We applied the full amount of payments of \$12.5 million and \$11.2 million for the nine months ended September 30, 2013 and 2012, respectively, as recoveries to the allowance for loan losses, resulting in a corresponding reduction to net charge-offs as well as provision for loan losses. Approximately \$20.3 million of loans were repurchased by or settled with the original sellers for the nine months ended September 30, 2013. A total of \$426.9 million of loans have been repurchased by the original sellers, including global settlements, since we actively started reviewing our purchased loan portfolio beginning in 2008.

CONCENTRATIONS OF CREDIT RISK

Loans

We track and review factors to predict and monitor credit risk in the mortgage loan portfolio on an ongoing basis. These factors include: loan type, estimated current loan-to-value ("LTV")/combined loan-to-value ("CLTV") ratios, delinquency history, documentation type, borrowers' current credit scores, housing prices, loan vintage and geographic location of the property. In economic conditions in which housing prices generally appreciate, we believe that loan type, LTV/CLTV ratios, documentation type and credit scores are the key factors in determining future loan performance. In a housing market with declining home prices and less credit available for refinance, we believe the LTV/CLTV ratio becomes a more important factor in predicting and monitoring credit risk. These factors are updated on at least a quarterly basis. 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 home equity loan portfolio is primarily second lien loans on residential real estate properties, which have a higher level of credit risk than first lien mortgage loans. Approximately 15% of the home equity loan portfolio was in the first lien position as of September 30, 2013. We held both the first and second lien positions in less than 1% of the home equity loan portfolio. The home equity loan portfolio consists of approximately 21% of home equity installment loans and approximately 79% of home equity lines of credit as of September 30, 2013.

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 9% of this portfolio will require the borrowers to repay the loan in full at the end of the draw period. At September 30, 2013, the majority of the home equity line of credit portfolio had not converted from the interest-only draw period and approximately 80% of this portfolio will not begin amortizing until after 2014. However, during the

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trailing twelve months ended September 30, 2013, approximately 40% of our borrowers made voluntary 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 home equity lines of credit convert to amortizing for the home equity line of credit portfolio as of September 30, 2013:

| <u>Period of Conversion to Amortizing Loan</u> | <u>% of Home Equity Line of Credit Portfolio</u> |
|--|--|
| Already amortizing | 11% |
| Through December 31, 2013 | 1% |
| Year ending December 31, 2014 | 8% |
| Year ending December 31, 2015 | 26% |
| Year ending December 31, 2016 | 41% |
| Year ending December 31, 2017 | 13% |

Additionally, in the current and anticipated interest rate environment, we do not expect interest rate resets to be a material driver of credit costs in the near future. As of September 30, 2013, a total of \$2.3 billion of one- to four-family loans had already reset for the first time and another \$1.9 billion were expected to reset for the first time in the next five years. We expect approximately \$0.6 billion of one- to four-family loans that have already reset to experience another interest rate reset in the remainder of 2013. We estimate that 1% of all one- to four-family loans expected to reset in the remainder of 2013 will experience a payment increase of more than 10% and approximately 77% are expected to reset to a lower payment in the remainder of 2013. The following table outlines the percentage of one- to four-family loans that have reset and are expected to reset for the first time as of September 30, 2013:

| <u>Period of First Interest Rate Reset</u> | <u>% of Total One- to Four-Family First Resets</u> |
|--|--|
| Already reset | 56% |
| Through December 31, 2013 | 2% |
| Year ending December 31, 2014 | 4% |
| Year ending December 31, 2015 | 5% |
| Year ending December 31, 2016 | 15% |
| Year ending December 31, 2017 | 18% |

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

| <u>Current LTV/CLTV⁽¹⁾</u> | <u>One- to Four-Family</u> | | <u>Home Equity</u> | |
|---|----------------------------|--------------------------|---------------------------|--------------------------|
| | <u>September 30, 2013</u> | <u>December 31, 2012</u> | <u>September 30, 2013</u> | <u>December 31, 2012</u> |
| <=80% | \$ 1,828.4 | \$ 1,324.2 | \$ 1,080.8 | \$ 927.5 |
| 80%-100% | 1,375.1 | 1,404.4 | 861.3 | 776.2 |
| 100%-120% | 853.4 | 1,231.5 | 789.7 | 932.0 |
| >120% | 656.1 | 1,482.1 | 887.2 | 1,587.7 |
| Total mortgage loans receivable | \$ 4,713.0 | \$ 5,442.2 | \$ 3,619.0 | \$ 4,223.4 |
| Average estimated current LTV/CLTV ⁽²⁾ | 93.8% | 108.1% | 101.7% | 113.8% |
| Average LTV/CLTV at loan origination ⁽³⁾ | 71.4% | 71.2% | 79.6% | 79.4% |

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

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

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

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| Documentation Type | One- to Four-Family | | Home Equity | |
|--|---------------------|-------------------|--------------------|-------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| Full documentation | \$ 1,956.2 | \$ 2,317.9 | \$ 1,851.5 | \$ 2,166.5 |
| Low/no documentation | 2,756.8 | 3,124.3 | 1,767.5 | 2,056.9 |
| Total mortgage loans receivable | \$ 4,713.0 | \$ 5,442.2 | \$ 3,619.0 | \$ 4,223.4 |

| Current FICO ⁽¹⁾ | One- to Four-Family | | Home Equity | |
|--|---------------------|-------------------|--------------------|-------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| ≥720 | \$2,370.5 | \$2,819.5 | \$1,896.8 | \$2,238.3 |
| 719 - 700 | 457.2 | 498.1 | 363.2 | 417.9 |
| 699 - 680 | 377.3 | 425.5 | 302.9 | 345.8 |
| 679 - 660 | 296.6 | 347.2 | 245.1 | 279.7 |
| 659 - 620 | 443.5 | 494.0 | 328.3 | 370.3 |
| <620 | 767.9 | 857.9 | 482.7 | 571.4 |
| Total mortgage loans receivable | \$4,713.0 | \$5,442.2 | \$3,619.0 | \$4,223.4 |

(1) FICO scores are updated on a quarterly basis; however, as of September 30, 2013 and December 31, 2012, there were some loans for which the updated FICO scores were not available. The current FICO distribution as of September 30, 2013 included original FICO scores for approximately \$101 million and \$10 million of one- to four-family and home equity loans, respectively. The current FICO distribution as of December 31, 2012 included original FICO scores for approximately \$121 million and \$20 million of one- to four-family and home equity loans, respectively.

| Vintage Year | One- to Four-Family | | Home Equity | |
|--|---------------------|-------------------|--------------------|-------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| 2003 and prior | \$ 153.8 | \$ 190.4 | \$ 166.9 | \$ 218.2 |
| 2004 | 449.0 | 514.3 | 293.9 | 359.7 |
| 2005 | 919.0 | 1,095.1 | 970.1 | 1,131.3 |
| 2006 | 1,865.5 | 2,123.4 | 1,702.3 | 1,962.9 |
| 2007 | 1,323.4 | 1,515.0 | 477.3 | 542.2 |
| 2008 | 2.3 | 4.0 | 8.5 | 9.1 |
| Total mortgage loans receivable | \$ 4,713.0 | \$ 5,442.2 | \$ 3,619.0 | \$ 4,223.4 |
| Average age of mortgage loans receivable (years) | 7.4 | 6.7 | 7.6 | 6.9 |

| Geographic Location | One- to Four-Family | | Home Equity | |
|--|---------------------|-------------------|--------------------|-------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| California | \$ 2,234.4 | \$ 2,568.7 | \$ 1,136.5 | \$ 1,333.3 |
| New York | 320.4 | 386.4 | 270.8 | 313.1 |
| Florida | 317.2 | 368.3 | 259.0 | 298.9 |
| Virginia | 212.4 | 235.0 | 164.7 | 192.1 |
| Other states | 1,628.6 | 1,883.8 | 1,788.0 | 2,086.0 |
| Total mortgage loans receivable | \$ 4,713.0 | \$ 5,442.2 | \$ 3,619.0 | \$ 4,223.4 |

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Approximately 40% of the Company's mortgage loans receivable were concentrated in California at both September 30, 2013 and December 31, 2012. No other state had concentrations of real estate loans that represented 10% or more of the Company's mortgage portfolio at September 30, 2013 or December 31, 2012.

Allowance for Loan Losses

The allowance for loan losses is management's estimate of probable losses inherent in the loan portfolio as of the balance sheet date. The estimate of the allowance for loan losses is based on a variety of quantitative and qualitative factors, including the composition and quality of the portfolio; delinquency levels and trends; current and historical charge-off and loss experience; our historical loss mitigation experience; the condition of the real estate market and geographic concentrations within the loan portfolio; the interest rate climate; the overall availability of housing credit; and general economic conditions. The allowance for loan losses is typically equal to management's forecast of loan losses in the twelve months following the balance sheet date as well as the forecasted losses, including economic concessions to borrowers, over the estimated remaining life of loans modified as TDRs. The general allowance for loan losses also included a qualitative component to account for a variety of factors that are not directly considered in the quantitative loss model but are factors we believe may impact the level of credit losses. The qualitative component was \$52 million and \$44 million at September 30, 2013 and December 31, 2012, respectively.

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

| | <u>One- to Four-Family</u> | | <u>Home Equity</u> | | <u>Consumer and Other</u> | | <u>Total</u> | |
|--------------------|----------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| | Allowance as a % of Loans | | Allowance as a % of Loans | | Allowance as a % of Loans | | Allowance as a % of Loans | |
| | Allowance | Receivable ⁽¹⁾ | Allowance | Receivable ⁽¹⁾ | Allowance | Receivable ⁽¹⁾ | Allowance | Receivable ⁽¹⁾ |
| September 30, 2013 | \$ 113.1 | 2.39% | \$ 319.1 | 8.76% | \$ 26.7 | 4.13% | \$ 458.9 | 5.09% |
| December 31, 2012 | \$ 183.9 | 3.37% | \$ 257.3 | 6.04% | \$ 39.5 | 4.62% | \$ 480.7 | 4.54% |

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

During the nine months ended September 30, 2013, the allowance for loan losses decreased by \$21.8 million from the level at December 31, 2012, driven primarily by improving credit trends and loan portfolio run-off. During the three and nine months ended September 30, 2013, we evaluated and refined our default assumptions related to a subset of the home equity line of credit portfolio that will require borrowers to repay the loan in full at the end of the draw period, commonly referred to as "balloon loans". These loans were approximately \$250 million of the home equity line of credit portfolio at September 30, 2013. We evaluated the significant burden a balloon payment may place on a borrower with a low FICO score and high CLTV ratio, and examined those loans within the balloon portfolio. We refined our expectations and estimates around the time period that it might take for these borrowers' equity positions in their collateral to appreciate in order to allow for possible refinance of the balloon loan at maturity. As a result of this evaluation, we increased our default assumptions and extended the period of management's forecasted loan losses captured within the general allowance to include the total probable loss on this subset of balloon loans. The overall impact of these enhancements drove the majority of provision for loan losses during the three and nine months ended September 30, 2013.

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The following table shows the trend of the ratio of the general allowance for loan losses, excluding the qualitative component, to loans that are 90+ days delinquent excluding modified TDRs (dollars in millions):

| | Total 90+ Days Delinquent Loans, Excluding Modified TDRs | General Allowance for Loan Losses Before Qualitative Component | Coverage Ratio |
|--------------------|--|---|-------------------|
| September 30, 2013 | \$ 247.0 | \$ 272.0 | 110% |
| June 30, 2013 | \$ 272.8 | \$ 257.6 | 94% |
| March 31, 2013 | \$ 310.0 | \$ 247.3 | 80% |
| December 31, 2012 | \$ 348.7 | \$ 265.2 | 76% |
| September 30, 2012 | \$ 383.3 | \$ 276.5 | 72% |

Troubled Debt Restructurings

TDRs include loan modifications completed under our programs that involve granting an economic concession to a borrower experiencing financial difficulty, as well as loans that have been charged-off based on the estimated current value of the underlying property less estimated selling costs due to bankruptcy notification. As of September 30, 2013, we had \$196.0 million net investment of TDRs that had been charged-off due to bankruptcy notification, of which \$106.2 million were classified as performing.

The following table shows the TDRs by delinquency category as of September 30, 2013 and December 31, 2012 (dollars in millions):

| | TDRs Current | TDRs 30-89 Days Delinquent | TDRs 90-179 Days Delinquent | TDRs 180+ Days Delinquent | Total Recorded Investment in TDRs |
|---------------------------|------------------|-------------------------------|--------------------------------|------------------------------|---|
| September 30, 2013 | | | | | |
| One- to four-family | \$ 920.6 | \$ 101.3 | \$ 44.3 | \$ 130.1 | \$ 1,196.3 |
| Home equity | 210.0 | 14.7 | 9.5 | 18.6 | 252.8 |
| Total | <u>\$1,130.6</u> | <u>\$ 116.0</u> | <u>\$ 53.8</u> | <u>\$ 148.7</u> | <u>\$ 1,449.1</u> |
| December 31, 2012 | | | | | |
| One- to four-family | \$ 927.6 | \$ 118.8 | \$ 48.6 | \$ 134.1 | \$ 1,229.1 |
| Home equity | 231.9 | 17.6 | 7.9 | 19.6 | 277.0 |
| Total | <u>\$1,159.5</u> | <u>\$ 136.4</u> | <u>\$ 56.5</u> | <u>\$ 153.7</u> | <u>\$ 1,506.1</u> |

TDRs on accrual status, which are current and have made six or more consecutive payments, were \$962.5 million and \$981.4 million at September 30, 2013 and December 31, 2012, respectively.

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Troubled Debt Restructurings—Loan Modifications

The following table shows TDR loan modifications by delinquency category as of September 30, 2013 and December 31, 2012 (dollars in millions):

| | <u>Modifications Current</u> | <u>Modifications 30-89 Days Delinquent</u> | <u>Modifications 90-179 Days Delinquent</u> | <u>Modifications 180+ Days Delinquent</u> | <u>Total Recorded Investment in Modifications</u> |
|---------------------------|----------------------------------|--|---|---|---|
| September 30, 2013 | | | | | |
| One- to four-family | \$ 833.9 | \$ 92.7 | \$ 40.3 | \$ 88.3 | \$ 1,055.2 |
| Home equity | 172.9 | 11.3 | 5.9 | 7.8 | 197.9 |
| Total | <u>\$ 1,006.8</u> | <u>\$ 104.0</u> | <u>\$ 46.2</u> | <u>\$ 96.1</u> | <u>\$ 1,253.1</u> |
| December 31, 2012 | | | | | |
| One- to four-family | \$ 838.0 | \$ 105.2 | \$ 43.9 | \$ 79.1 | \$ 1,066.2 |
| Home equity | 195.0 | 15.1 | 6.2 | 7.1 | 223.4 |
| Total | <u>\$ 1,033.0</u> | <u>\$ 120.3</u> | <u>\$ 50.1</u> | <u>\$ 86.2</u> | <u>\$ 1,289.6</u> |

Included in allowance for loan losses was a specific valuation allowance of \$135.4 million and \$171.4 million that was established for modifications at September 30, 2013 and December 31, 2012, 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 following table shows TDR loan modifications and the specific valuation allowance by loan portfolio as well as the percentage of total expected losses as of September 30, 2013 and December 31, 2012 (dollars in millions):

| | <u>Recorded Investment in Modifications before Charge-offs</u> | <u>Charge-offs</u> | <u>Recorded Investment in Modifications</u> | <u>Specific Valuation Allowance</u> | <u>Net Investment in Modifications</u> | <u>Specific Valuation Allowance as a % of Modifications</u> | <u>Total Expected Losses</u> |
|---------------------------|--|--------------------|---|---|--|---|--------------------------------------|
| September 30, 2013 | | | | | | | |
| One- to four-family | \$ 1,374.6 | \$ (319.4) | \$ 1,055.2 | \$ (67.8) | \$ 987.4 | 6% | 28% |
| Home equity | 347.9 | (150.0) | 197.9 | (67.6) | 130.3 | 34% | 63% |
| Total | <u>\$ 1,722.5</u> | <u>\$ (469.4)</u> | <u>\$ 1,253.1</u> | <u>\$ (135.4)</u> | <u>\$ 1,117.7</u> | 11% | 35% |
| December 31, 2012 | | | | | | | |
| One- to four-family | \$ 1,383.3 | \$ (317.1) | \$ 1,066.2 | \$ (89.7) | \$ 976.5 | 8% | 29% |
| Home equity | 382.6 | (159.2) | 223.4 | (81.7) | 141.7 | 37% | 63% |
| Total | <u>\$ 1,765.9</u> | <u>\$ (476.3)</u> | <u>\$ 1,289.6</u> | <u>\$ (171.4)</u> | <u>\$ 1,118.2</u> | 13% | 37% |

The recorded investment in TDR loan modifications includes the charge-offs related to certain loans that were written down to the estimated current value of the underlying property less estimated costs to sell. These charge-offs were recorded on modified loans that were delinquent in excess of 180 days or in bankruptcy and on TDRs when certain characteristics of the loan, including CLTV, borrower's credit and type of modification, cast substantial doubt on the borrower's ability to repay the loan. The total expected loss on TDR loan modifications includes both the previously recorded charge-offs and the specific valuation allowance. Total expected losses on TDR loan modifications decreased slightly from 37% at December 31, 2012 to 35% at September 30, 2013.

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Net Charge-offs

The following table provides an analysis of the allowance for loan losses and net charge-offs for the three and nine months ended September 30, 2013 and 2012 (dollars in millions):

| | <u>Charge-offs</u> | <u>Recoveries⁽¹⁾</u> | <u>Net Charge-offs</u> | <u>% of Average Loans (Annualized)</u> |
|--|--------------------|---------------------------------|------------------------|--|
| Three Months Ended September 30, 2013 | | | | |
| One- to four-family | \$ (6.7) | \$ — | \$ (6.7) | 0.55% |
| Home equity | (29.6) | 9.7 | (19.9) | 2.13% |
| Consumer and other | (5.6) | 2.8 | (2.8) | 1.67% |
| Total | <u>\$ (41.9)</u> | <u>\$ 12.5</u> | <u>\$ (29.4)</u> | 1.27% |
| Three Months Ended September 30, 2012 | | | | |
| One- to four-family | \$ (34.2) | \$ — | \$ (34.2) | 2.34% |
| Home equity | (120.3) | 9.3 | (111.0) | 9.04% |
| Consumer and other | (17.1) | 3.8 | (13.3) | 5.58% |
| Total | <u>\$ (171.6)</u> | <u>\$ 13.1</u> | <u>\$ (158.5)</u> | 5.41% |
| Nine Months Ended September 30, 2013 | | | | |
| One- to four-family | \$ (36.7) | \$ 14.5 | \$ (22.2) | 0.58% |
| Home equity | (132.9) | 26.1 | (106.8) | 3.58% |
| Consumer and other | (28.4) | 9.4 | (19.0) | 3.42% |
| Total | <u>\$ (198.0)</u> | <u>\$ 50.0</u> | <u>\$ (148.0)</u> | 2.01% |
| Nine Months Ended September 30, 2012 | | | | |
| One- to four-family | \$ (157.9) | \$ 9.3 | \$ (148.6) | 3.23% |
| Home equity | (445.5) | 30.0 | (415.5) | 10.73% |
| Consumer and other | (40.3) | 9.6 | (30.7) | 4.03% |
| Total | <u>\$ (643.7)</u> | <u>\$ 48.9</u> | <u>\$ (594.8)</u> | 6.44% |

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

Loan losses are recognized when it is probable that a loss has been incurred. The charge-off policy for both one- to four-family and home equity loans is to assess the value of the property when the loan has been delinquent for 180 days or is in bankruptcy, regardless of whether or not the property is in foreclosure, and charge-off the amount of the loan balance in excess of the estimated current value of the underlying property less estimated costs to sell. TDRs are charged-off when they are identified as collateral dependent based on the terms of the modification, which includes assigning a higher level of risk to loans in which the LTV or CLTV is greater than 110%, a borrower's credit score is less than 600 and certain types of modifications, such as interest-only payments and terms longer than 30 years. Consumer loans are charged-off when the loan has been 120 days delinquent or when it is determined that collection is not probable.

Net charge-offs for the three and nine months ended September 30, 2013 compared to the same periods in 2012 decreased by \$129.1 million and \$446.8 million, respectively. Net charge-offs for the nine months ended September 30, 2013 and 2012 included \$12.5 million and \$11.2 million, respectively, of benefit recorded from settlements with third party mortgage originators. The timing and magnitude of charge-offs are affected by many factors, and we anticipate variability from quarter to quarter while continuing to see a downward trend over the long term.

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During the first quarter of 2012, we completed an evaluation of certain programs and practices that were designed in accordance with guidance from our former regulator, the OTS, which resulted in loan modification policies and procedures being aligned with the guidance from the OCC and a significant increase in charge-offs during the first quarter of 2012.

We utilize third party loan servicers to obtain bankruptcy data on our borrowers and during the third quarter of 2012, we identified an increase in bankruptcies reported by one specific servicer. In researching this increase, we discovered that the servicer had not been reporting historical bankruptcy data on a timely basis. As a result, we implemented an enhanced procedure around all servicer reporting to corroborate bankruptcy reporting with independent third party data. Through this additional process, approximately \$90 million of loans were identified in which servicers failed to report the bankruptcy filing to us, approximately 90% of which were current at September 30, 2012. As a result, these loans were written down to the estimated current value of the underlying property less estimated selling costs, or approximately \$40 million, during the third quarter of 2012. These newly identified bankruptcy filings resulted in an increase to net charge-offs and provision for loan losses of \$50 million for the three months ended September 30, 2012, with approximately 80% related to prior years.

Nonperforming Assets

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

| | September 30, 2013 | December 31, 2012 |
|--|-----------------------|----------------------|
| One- to four-family | \$ 547.3 | \$ 639.1 |
| Home equity | 180.3 | 247.5 |
| Consumer and other | 2.5 | 6.4 |
| Total nonperforming loans | 730.1 | 893.0 |
| REO and other repossessed assets, net | 51.4 | 71.2 |
| Total nonperforming assets, net | \$ 781.5 | \$ 964.2 |
| Nonperforming loans receivable as a percentage of gross loans receivable | 8.09% | 8.44% |
| One- to four-family allowance for loan losses as a percentage of one- to four-family nonperforming loans | 20.67% | 28.77% |
| Home equity allowance for loan losses as a percentage of home equity nonperforming loans | 176.98% | 103.96% |
| Consumer and other allowance for loan losses as a percentage of consumer and other nonperforming loans | 1068.00% | 617.19% |
| Total allowance for loan losses as a percentage of total nonperforming loans | 62.85% | 53.83% |

During the nine months ended September 30, 2013, nonperforming assets, net decreased \$182.7 million to \$781.5 million when compared to December 31, 2012. This was attributed primarily to decreases in one- to four-family and home equity nonperforming loans driven by improving credit trends.

Delinquent Loans

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

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when compared to the expected charge-offs on loans delinquent 90 to 179 days. We expect the balances of one- to four-family loans delinquent 180 days and greater to decline over time; however, we expect the balances to remain at high levels in the near term due to the extensive amount of time it takes to foreclose on a property in the current real estate market. The following table shows the comparative data for loans delinquent 90 to 179 days (dollars in millions):

| | September 30, 2013 | December 31, 2012 |
|--|-----------------------|----------------------|
| One- to four-family | \$ 71.0 | \$ 94.7 |
| Home equity | 38.5 | 64.2 |
| Consumer and other loans | 2.5 | 6.2 |
| Total loans delinquent 90-179 days | <u>\$ 112.0</u> | <u>\$ 165.1</u> |
| Loans delinquent 90-179 days as a percentage of gross loans receivable | 1.24% | 1.56% |

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):

| | September 30, 2013 | December 31, 2012 |
|--|-----------------------|----------------------|
| One- to four-family | \$ 196.5 | \$ 233.8 |
| Home equity | 69.5 | 89.3 |
| Consumer and other loans | 12.1 | 19.1 |
| Total special mention loans | <u>\$ 278.1</u> | <u>\$ 342.2</u> |
| Special mention loans receivable as a percentage of gross loans receivable | 3.08% | 3.23% |

The trend in special mention loan balances is generally indicative of the expected trend for charge-offs in future periods, as these loans have a greater propensity to migrate into nonaccrual status and ultimately charge-off. One- to four-family loans are generally secured in a first lien position by real estate assets, reducing the potential loss when compared to an unsecured loan. Home equity loans are generally secured by real estate assets; however, the majority of these loans are secured in a second lien position, which substantially increases the potential loss when compared to a first lien position. The loss severity of our second lien home equity loans is approximately 94%.

During the nine months ended September 30, 2013, special mention loans decreased by \$64.1 million to \$278.1 million and are down 72% from their peak of \$1.0 billion as of December 31, 2008. This decrease was largely due to a decrease in both one- to four-family and home equity special mention loans. While the level of special mention loans can fluctuate significantly in any given period, we believe the continued decrease is an encouraging sign regarding the future credit performance of the mortgage loan portfolio.

Securities

We focus primarily on security type and credit rating to monitor credit risk in our securities portfolios. The table below details the amortized cost of municipal bonds, corporate bonds and non-agency debt securities by average credit ratings and type of asset as of September 30, 2013 and December 31, 2012 (dollars in millions):

| September 30, 2013 | AAA | AA | A | BBB | Below Investment Grade and Non-Rated | Total |
|-------------------------------------|---------------|---------------|------------|--------------|---|---------------|
| Municipal bonds and corporate bonds | \$29.8 | \$19.8 | \$— | \$5.5 | \$ — | \$55.1 |
| Non-agency CMOs | — | — | — | — | 18.6 | 18.6 |
| Total | <u>\$29.8</u> | <u>\$19.8</u> | <u>\$—</u> | <u>\$5.5</u> | <u>\$ 18.6</u> | <u>\$73.7</u> |

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

We also held \$23.3 billion and \$22.5 billion of agency mortgage-backed securities and CMOs, agency debentures and agency debt securities at September 30, 2013 and December 31, 2012, respectively. We consider securities backed by the U.S. government or its agencies to have low credit risk as the long-term debt rating of the U.S. government is AA+ by S&P and AAA by Moody's and Fitch.

Certain non-agency CMOs were other-than-temporarily impaired as a result of the deterioration in the expected credit performance of the underlying loans in those specific securities. As of September 30, 2013, we held approximately \$18.6 million in amortized cost of non-agency CMOs that had been other-than-temporarily impaired. We recorded \$0.6 million and \$2.4 million of net impairment for the three months ended September 30, 2013 and 2012, respectively, and \$2.3 million and \$11.2 million of net impairment for the nine months ended September 30, 2013 and 2012, respectively, related to other-than-temporarily impaired non-agency CMOs. During the first quarter of 2013, we sold \$230.5 million amortized cost of available-for-sale non-agency CMOs as part of our focus to reduce risk and deleverage the balance sheet. Further declines in the performance of our remaining non-agency CMO portfolio could result in additional impairments in future periods.

SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with GAAP. Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies of Item 8. Financial Statements and Supplementary Data in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, as updated in this report, contains a summary of our significant accounting policies, many of which require the use of estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the periods presented. We believe that of our significant accounting policies, the following are noteworthy because they are based on estimates and assumptions that require complex and subjective judgments by management: allowance for loan losses; valuation of goodwill and other intangible assets; estimates of effective tax rates, deferred taxes and valuation allowance; classification and valuation of certain investments; accounting for derivative instruments; and fair value measurements. Changes in these estimates or assumptions could materially impact our financial condition and results of operations and actual results could differ from our estimates. The accounting policies and estimates discussions for allowance for loan losses and valuation of goodwill and other intangible assets have been updated for the period ended September 30, 2013 to reflect significant changes in estimates.

Allowance for Loan Losses

Description

The allowance for loan losses is management's estimate of probable losses inherent in the loan portfolio as of the balance sheet date. In determining the adequacy of the allowance, we perform periodic evaluations of the loan portfolio and loss forecasting assumptions. As of September 30, 2013, the allowance for loan losses was \$458.9 million on \$9.0 billion of total loans receivable designated as held-for-investment.

Judgments

Determining the adequacy of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses in future periods. We evaluate the adequacy of the allowance for loan losses by loan portfolio segment: one- to four-family, home equity and consumer and other. The estimate of the allowance for loan losses is based on a variety of quantitative and qualitative factors, including the composition and quality of the portfolio; delinquency levels and trends; current and historical charge-off and loss experience; our historical loss mitigation experience; the condition of the real estate market and geographic concentrations within the loan portfolio; the interest rate climate; the overall availability of housing credit; and general economic conditions. The allowance for loan losses is typically equal to management's forecast of loan losses in the twelve months following the balance sheet date as well as the forecasted losses, including economic concessions to borrowers, over the estimated remaining life of loans modified as TDRs.

For loans that are not TDRs, we established a general allowance. The one- to four-family and home equity loan portfolios are separated into risk segments based on key risk factors, which include but are not limited to loan type, delinquency history, documentation type, LTV/CLTV ratio and borrowers' credit scores. 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. Both current CLTV and FICO scores are among the factors utilized to categorize the risk associated with mortgage loans and assign a probability assumption of future default. We utilize historical mortgage loan performance data to develop the forecast of delinquency and default for these risk segments. During the three and nine months ended September 30, 2013, we evaluated and refined our default assumptions related to a subset of the home equity line of credit portfolio that will require borrowers to repay the loan in full at the end of the draw period, commonly referred to as "balloon loans". These loans were approximately \$250 million of the home equity line of credit portfolio at September 30, 2013. We evaluated the significant burden a balloon payment may place on a borrower with a low FICO score and high CLTV ratio, and examined those loans within the balloon portfolio. We refined our expectations and estimates around the time period that it might take for these borrowers' equity positions in their collateral to appreciate in order to allow for possible refinance of the balloon loan at maturity. As a result of this evaluation, we increased our default assumptions and extended the period of management's forecasted loan losses captured within the general allowance to include the total probable loss on this subset of balloon loans. The overall impact of these enhancements drove the majority of provision for loan losses during the three and nine months ended September 30, 2013. The consumer and other loan portfolio is separated into risk segments by product and delinquency status. We utilize historical performance data and historical recovery rates on collateral liquidation to forecast delinquency and loss at the product level. The one- to four-family and home equity loan portfolios represented 53% and 40%, respectively, of total loans receivable as of September 30, 2013. The consumer and other loan portfolio represented 7% of total loans receivable as of September 30, 2013.

The general allowance for loan losses also included a qualitative component to account for a variety of factors that are not directly considered in the quantitative loss model but are factors we believe may impact the level of credit losses. Examples of these factors are: external factors, such as changes in the macro-economic, legal and regulatory environment; internal factors, such as procedural changes and reliance on third parties; and portfolio specific factors, such as the impact of payment resets and historical loan modification activity, which impacts the historical performance data used to forecast delinquency and default in the general allowance for loan losses.

The total qualitative component was \$52 million and \$44 million at September 30, 2013 and December 31, 2012, respectively. The qualitative component for the one- to four-family and home equity loan portfolios was 19% and 17% of the general allowance for loan losses at September 30, 2013 and December 31, 2012, respectively. The increase in the qualitative reserve in these loan portfolios from December 31, 2012 to September 30, 2013 primarily reflects updates to portfolio specific factors. The qualitative component for the consumer and other loan portfolio was 16% and 17% of the general allowance at September 30, 2013 and December 31, 2012, respectively.

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For modified loans accounted for as TDRs that are valued using the discounted cash flow model, we established a specific allowance. The specific allowance for TDRs factors in the historical default rate of an individual loan before being modified as a TDR in the discounted cash flow analysis in order to determine that specific loan's expected impairment. Specifically, a loan that has a more severe delinquency history prior to modification will have a higher future default rate in the discounted cash flow analysis than a loan that was not as severely delinquent. For both of the one- to four-family and home equity loan portfolio segments, the pre-modification delinquency status, the borrower's current credit score and other credit bureau attributes, in addition to each loan's individual default experience and credit characteristics, are incorporated into the calculation of the specific allowance. A specific allowance is established to the extent that the recorded investment exceeds the discounted cash flows of a TDR with a corresponding charge to provision for loan losses. The specific allowance for these individually impaired loans represents the forecasted losses over the estimated remaining life of the loan, including the economic concession to the borrower.

Effects if Actual Results Differ

The crisis in the residential real estate and credit markets has substantially increased the complexity and uncertainty involved in estimating the losses inherent in the loan portfolio. In the current market it is difficult to estimate how potential changes in the quantitative and qualitative factors might impact the allowance for loan losses. If our underlying assumptions and judgments prove to be inaccurate, the allowance for loan losses could be insufficient to cover actual losses. We may be required under such circumstances to further increase the provision for loan losses, which could have an adverse effect on the regulatory capital position and results of operations in future periods.

During the normal course of conducting examinations, our banking regulators, the OCC and Federal Reserve, continue to review our business and practices. This process is dynamic and ongoing and we cannot be certain that additional changes or actions will not result from their continuing review.

Valuation of Goodwill and Other Intangible Assets

Description

Goodwill and other intangible assets are evaluated for impairment on at least an annual basis or when events or changes indicate the carrying value may not be recoverable. Goodwill and other intangible assets net of amortization were \$1.8 billion and \$0.2 billion, respectively, at September 30, 2013.

Judgments

Estimating the fair value of reporting units and the assets, liabilities and intangible assets of a reporting unit is a subjective process that involves the use of estimates and judgments, particularly related to cash flows, the appropriate discount rates and an applicable control premium. Management judgment is required to assess whether the carrying value of the reporting unit can be supported by the fair value of the individual reporting unit. There are various valuation methodologies, such as the market approach or discounted cash flow methods, that may be used to estimate the fair value of reporting units. In applying these methodologies, we utilize a number of factors, including actual operating results, future business plans, economic projections, and market data.

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Goodwill is allocated to reporting units, which are components of the business that are one level below operating segments. There is no goodwill assigned to reporting units within the balance sheet management segment. The following table shows the comparative data for the amount of goodwill allocated to each of the reporting units (dollars in millions):

| Reporting Unit | September 30, 2013 | December 31, 2012 |
|------------------|-----------------------|----------------------|
| Retail Brokerage | \$ 1,791.8 | \$ 1,791.8 |
| Market Making | — | 142.4 |
| Total goodwill | <u>\$ 1,791.8</u> | <u>\$ 1,934.2</u> |

In conducting the goodwill impairment test for 2012, the estimated fair value of the market making reporting unit as a percentage of book value was approximately 115%; therefore, we expected that if actual cash flows were less than our estimated cash flows, goodwill impairment could occur in the market making reporting unit. We monitored these cash flows closely during both the first quarter and second quarter of 2013 to determine if a further evaluation of potential impairment was necessary so that impairment could be recognized in a timely manner.

During the second quarter of 2013, we also performed an evaluation of the strategic options for our market making business. In addition to the economic conditions considered, the evaluation considered the risks, both operational and regulatory, of the market making business as well as our assessment that the market making business is not core to our retail customer business. As a result of this evaluation, at the end of June 2013 we made the decision to exit the market making business and pursue a sale and contractual order flow agreements.

Based on the second quarter of 2013 events, we proceeded with the first step of the goodwill impairment test for the market making reporting unit. In conducting the goodwill impairment test for the market making reporting unit, we refined the estimated fair value of the market making reporting unit using the expected sale structure of the market making business. This structure assumed a shorter period of cash flows related to an order flow arrangement, compared to prior estimates of fair value. Based on the results of the first step of the goodwill impairment test, we determined that the carrying value of the market making reporting unit, including goodwill, exceeded the fair value for that reporting unit as of June 30, 2013. We proceeded to the second step of the goodwill impairment test to measure the amount of goodwill impairment. As the entire carrying amount of the goodwill allocated to the market making reporting unit exceeded the implied fair value of goodwill, we recognized \$142.4 million of goodwill impairment in the consolidated statement of income (loss) for the second quarter of 2013.

We also evaluate the remaining useful lives on intangible assets each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. In the second quarter of 2013, pursuant to our decision to exit the market making reporting unit, we reclassified \$21.2 million of the other intangible assets related to the market making reporting unit as held-for-sale. These held-for-sale intangible assets have been included in the other assets line item in the consolidated balance sheet as of September 30, 2013. The remaining other intangible assets have a weighted average remaining useful life of 12 years as of September 30, 2013. We did not recognize impairment on our other intangible assets in the periods presented.

Effects if Actual Results Differ

If our estimates of fair value for the retail brokerage reporting unit change due to changes in our business or other factors, we may determine that an impairment charge is necessary. Estimates of fair value are determined based on a complex model using estimated future cash flows and company comparisons. If the actual cash flows are less than the estimated future cash flows used in the annual assessment, then goodwill would have to be tested for impairment.

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Intangible assets are amortized over their estimated useful lives. If changes in the estimated underlying revenue occur, impairment or a change in the remaining life may need to be recognized.

GLOSSARY OF TERMS

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

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

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

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

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

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

ALCO—Asset Liability Committee.

AML—Anti-Money Laundering.

APIC—Additional paid-in capital.

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

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

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

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

BCBS—International Basel Committee on Banking Supervision.

BOLI—Bank-Owned Life Insurance.

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

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

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

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

CFPB—Consumer Financial Protection Bureau.

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

CLTV—Combined loan-to-value.

CMOs—Collateralized mortgage obligations.

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

Customer assets—Market value of all customer assets held by the Company including security holdings, customer payables and deposits, 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 forward contracts, options and swaps.

DIF—Depositors Insurance Fund.

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

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

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

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

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

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

ESDA—Extended insurance sweep deposit accounts.

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

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

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

Fannie Mae—Federal National Mortgage Association.

FASB—Financial Accounting Standards Board.

FCA—United Kingdom Financial Conduct Authority.

FDIC—Federal Deposit Insurance Corporation.

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

FHLB—Federal Home Loan Bank.

FICO—Fair Isaac Credit Organization.

FINRA—Financial Industry Regulatory Authority.

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

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

Freddie Mac—Federal Home Loan Mortgage Corporation.

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

Ginnie Mae—Government National Mortgage Association.

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

IFRS—International Financial Reporting Standards.

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

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

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

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

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

LTV—Loan-to-value.

NASDAQ—National Association of Securities Dealers Automated Quotations.

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

NOLs—Net operating losses.

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

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

NYSE—New York Stock Exchange.

OCC—Office of the Comptroller of the Currency.

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

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

OTTI—Other-than-temporary impairment.

OTS—Office of Thrift Supervision.

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

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

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

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

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

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

S&P—Standard & Poor's.

SEC—U.S. Securities and Exchange Commission.

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

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

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

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

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

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following discussion about market risk disclosure includes forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of certain factors, including, but not limited to, those set forth in Item 1A. Risk Factors in the Annual Report on Form 10-K for the year ended December 31, 2012, 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, the vast majority of which are held for non-trading purposes. The management of interest rate risk is essential to profitability. The primary objective of the management of interest rate risk is to control exposure to interest rates within the Board-approved limits, as outlined in the scenario analysis below, and with limited exposure to earnings volatility resulting from interest rate fluctuations. Our general strategies to manage interest rate risk include balancing variable-rate and fixed-rate assets and liabilities and utilizing derivatives in a way that

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

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

Exposure to interest rate risk is dependent upon the distribution and composition of interest-earning assets, interest-bearing liabilities and derivatives. The differing risk characteristics of each product are managed to mitigate our exposure to interest rate fluctuations. At September 30, 2013, 91% of our total assets were enterprise interest-earning assets.

At September 30, 2013, approximately 64% of total assets were residential real estate loans and available-for-sale and held-to-maturity mortgage-backed securities. The values of these assets are sensitive to changes in interest rates, as well as expected prepayment levels. As interest rates increase, fixed rate residential mortgages and mortgage-backed securities tend to exhibit lower prepayments. The inverse is true in a falling rate environment.

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

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

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

Derivative Instruments

We use derivative instruments to help manage interest rate risk. Interest rate swaps involve the exchange of fixed-rate and variable-rate interest payments between two parties based on a contractual underlying notional amount, but do not involve the exchange of the underlying notional amounts. Option products are utilized primarily to decrease the market value changes resulting from the prepayment dynamics of the mortgage portfolio, as well as to protect against increases in funding costs. The types of options employed include Cap Options (“Caps”), Floor Options (“Floors”), “Payor Swaptions” and “Receiver Swaptions”. Caps mitigate the market risk associated with increases in interest rates while Floors mitigate the risk associated with decreases in market interest rates. Similarly, Payor and Receiver Swaptions mitigate the market risk associated with the respective increases and decreases in interest rates. See derivative instruments discussion in Note 7—Accounting for Derivative Instruments and Hedging Activities in Item 1. Consolidated Financial Statements (Unaudited).

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

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

The EVE method is used at the E*TRADE Bank level and not for the Company. The ALCO monitors E*TRADE Bank’s interest rate risk position. E*TRADE Bank had nearly 100% of enterprise interest-earning assets at both September 30, 2013 and December 31, 2012 and held 99% of enterprise interest-bearing liabilities at both September 30, 2013 and December 31, 2012. The sensitivity of EVE at September 30, 2013 and December 31, 2012 and the limits established by E*TRADE Bank’s Board of Directors are listed below (dollars in millions):

| Parallel Change in Interest Rates (basis points) ⁽¹⁾ | Change in EVE | | | | Board Limit |
|--|--------------------|---------------------------|-------------------|---------------------------|-------------|
| | September 30, 2013 | | December 31, 2012 | | |
| | Amount | Percentage ⁽²⁾ | Amount | Percentage ⁽²⁾ | |
| +300 | \$(587.2) | (12.9)% | \$(446.3) | (11.1)% | (25)% |
| +200 | \$(340.6) | (7.5)% | \$(168.5) | (4.2)% | (15)% |
| +100 | \$(121.6) | (2.7)% | \$ 23.6 | 0.6% | (7)% |
| -100 | \$(108.2) | (2.4)% | \$(175.6) | (4.4)% | (7)% |

(1) On September 30, 2013 and December 31, 2012 the yield for the three-month treasury bill was 0.02% and 0.05%, respectively. As a result, the requirements of the EVE model were temporarily modified, resulting in the removal of the minus 200 and 300 basis points scenarios for the periods ended September 30, 2013 and December 31, 2012.

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

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

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PART I-FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------------------|------------------------------------|------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenue: | | | | |
| Operating interest income | \$300,915 | \$333,977 | \$ 902,805 | \$1,050,758 |
| Operating interest expense | (60,068) | (73,100) | (178,088) | (225,924) |
| Net operating interest income | <u>240,847</u> | <u>260,877</u> | <u>724,717</u> | <u>824,834</u> |
| Commissions | 102,753 | 90,424 | 309,846 | 291,168 |
| Fees and service charges | 39,924 | 30,915 | 112,801 | 91,976 |
| Principal transactions | 12,631 | 22,177 | 55,553 | 67,562 |
| Gains on loans and securities, net | 12,213 | 78,977 | 48,954 | 138,568 |
| Other-than-temporary impairment ("OTTI") | — | (2,052) | (632) | (16,113) |
| Less: noncredit portion of OTTI recognized into (out of) other comprehensive income (loss) (before tax) | (586) | (343) | (1,699) | 4,917 |
| Net impairment | (586) | (2,395) | (2,331) | (11,196) |
| Other revenues | 9,020 | 9,060 | 27,058 | 28,928 |
| Total non-interest income | <u>175,955</u> | <u>229,158</u> | <u>551,881</u> | <u>607,006</u> |
| Total net revenue | <u>416,802</u> | <u>490,035</u> | <u>1,276,598</u> | <u>1,431,840</u> |
| Provision for loan losses | 37,399 | 141,019 | 126,198 | 280,227 |
| Operating expense: | | | | |
| Compensation and benefits | 88,405 | 94,790 | 270,077 | 272,617 |
| Advertising and market development | 20,925 | 26,001 | 80,793 | 110,156 |
| Clearing and servicing | 30,941 | 30,856 | 93,647 | 98,248 |
| FDIC insurance premiums | 24,707 | 31,342 | 79,052 | 86,899 |
| Professional services | 22,842 | 20,421 | 58,778 | 60,690 |
| Occupancy and equipment | 17,675 | 19,423 | 53,344 | 55,521 |
| Communications | 15,279 | 17,560 | 52,411 | 55,038 |
| Depreciation and amortization | 21,839 | 23,044 | 67,684 | 68,387 |
| Amortization of other intangibles | 5,699 | 6,296 | 17,833 | 18,887 |
| Impairment of goodwill | — | — | 142,423 | — |
| Facility restructuring and other exit activities | 6,410 | 2,350 | 23,871 | 3,515 |
| Other operating expenses | 16,022 | 16,950 | 40,293 | 46,769 |
| Total operating expense | <u>270,744</u> | <u>289,033</u> | <u>980,206</u> | <u>876,727</u> |
| Income before other income (expense) and income tax expense (benefit) | 108,659 | 59,983 | 170,194 | 274,886 |
| Other income (expense): | | | | |
| Corporate interest income | 9 | 21 | 33 | 55 |
| Corporate interest expense | (28,605) | (45,483) | (85,838) | (135,893) |
| Losses on early extinguishment of debt | — | (50,608) | — | (50,608) |
| Equity in income (loss) of investments and other | (133) | (216) | 5,127 | 1,791 |
| Total other income (expense) | <u>(28,729)</u> | <u>(96,286)</u> | <u>(80,678)</u> | <u>(184,655)</u> |
| Income (loss) before income tax expense (benefit) | 79,930 | (36,303) | 89,516 | 90,231 |
| Income tax expense (benefit) | 32,502 | (7,678) | 61,367 | 16,755 |
| Net income (loss) | <u>\$ 47,428</u> | <u>\$ (28,625)</u> | <u>\$ 28,149</u> | <u>\$ 73,476</u> |
| Basic earnings (loss) per share | \$ 0.17 | \$ (0.10) | \$ 0.10 | \$ 0.26 |
| Diluted earnings (loss) per share | \$ 0.16 | \$ (0.10) | \$ 0.10 | \$ 0.25 |
| Shares used in computation of per share data: | | | | |
| Basic | 287,111 | 285,850 | 286,882 | 285,658 |
| Diluted | 292,630 | 285,850 | 292,249 | 290,395 |

See accompanying notes to consolidated financial statements

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------------|------------------------------------|-------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income (loss) | \$ 47,428 | \$(28,625) | \$ 28,149 | \$ 73,476 |
| Other comprehensive income (loss) | | | | |
| Available-for-sale securities: | | | | |
| OTTI, net ⁽¹⁾ | — | 1,291 | 393 | 10,071 |
| Noncredit portion of OTTI reclassification (into) out of other comprehensive income (loss), net ⁽²⁾ | 361 | 215 | 1,055 | (3,071) |
| Unrealized gains (losses), net ⁽³⁾ | 18,463 | 85,928 | (202,552) | 179,257 |
| Reclassification into earnings, net ⁽⁴⁾ | (9,677) | (50,349) | (30,660) | (90,948) |
| Net change from available-for-sale securities | 9,147 | 37,085 | (231,764) | 95,309 |
| Cash flow hedging instruments: | | | | |
| Unrealized gains (losses), net ⁽⁵⁾ | (11,894) | (21,905) | 56,575 | (73,602) |
| Reclassification into earnings, net ⁽⁶⁾ | 21,214 | 20,471 | 64,357 | 60,329 |
| Net change from cash flow hedging instruments | 9,320 | (1,434) | 120,932 | (13,273) |
| Foreign currency translation gains, net | 582 | 1,645 | 142 | 1,190 |
| Other comprehensive income (loss) | 19,049 | 37,296 | (110,690) | 83,226 |
| Comprehensive income (loss) | <u>\$ 66,477</u> | <u>\$ 8,671</u> | <u>\$ (82,541)</u> | <u>\$ 156,702</u> |

(1) Amounts are net of benefit from income taxes of \$0.2 million for the nine months ended September 30, 2013, compared to benefit from income taxes of \$0.8 million and \$6.0 million for the three and nine months ended September 30, 2012, respectively.

(2) Amounts are net of benefit from income taxes of \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2013, respectively, compared to benefit from income taxes of \$0.1 million and \$1.8 million for the three and nine months ended September 30, 2012, respectively.

(3) Amounts are net of provision from income taxes of \$11.5 million and benefit from \$120.2 million for the three and nine months ended September 30, 2013, respectively, compared to provision for income taxes of \$50.7 million and \$106.9 million for the three and nine months ended September 30, 2012, respectively.

(4) Amounts are net of provision for income taxes of \$6.0 million and \$18.6 million for the three and nine months ended September 30, 2013, respectively, compared to provision for income taxes of \$29.7 million and \$54.1 million for the three and nine months ended September 30, 2012, respectively.

(5) Amounts are net of benefit from income taxes of \$7.8 million and provision for \$26.8 million for the three and nine months ended September 30, 2013, respectively, compared to benefit from income taxes of \$11.7 million and \$42.7 million for the three and nine months ended September 30, 2012, respectively.

(6) Amounts are net of benefit from income taxes of \$13.8 million and \$37.9 million for the three and nine months ended September 30, 2013, respectively, compared to benefit from income taxes of \$12.3 million and \$36.5 million for the three and nine months ended September 30, 2012, respectively.

See accompanying notes to the consolidated financial statements

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

| | September 30, 2013 | December 31, 2012 |
|---|-----------------------|----------------------|
| <u>ASSETS</u> | | |
| Cash and equivalents | \$ 1,796,181 | \$ 2,761,494 |
| Cash required to be segregated under federal or other regulations | 738,221 | 376,898 |
| Trading securities | — | 101,270 |
| Available-for-sale securities | 13,281,458 | 13,443,020 |
| Held-to-maturity securities (fair value of \$9,977,373 at September 30, 2013 and \$9,910,496 at December 31, 2012) | 9,944,153 | 9,539,948 |
| Margin receivables | 6,188,708 | 5,804,041 |
| Loans receivable, net (net of allowance for loan losses of \$458,921 at September 30, 2013 and \$480,751 at December 31, 2012) | 8,564,614 | 10,098,723 |
| Investment in FHLB stock | 61,400 | 67,400 |
| Property and equipment, net | 246,186 | 288,170 |
| Goodwill | 1,791,809 | 1,934,232 |
| Other intangibles, net | 221,628 | 260,622 |
| Other assets | <u>2,713,121</u> | <u>2,710,921</u> |
| Total assets | <u>\$45,547,479</u> | <u>\$47,386,739</u> |
| <u>LIABILITIES AND SHAREHOLDERS' EQUITY</u> | | |
| Liabilities: | | |
| Deposits | \$25,869,797 | \$28,392,552 |
| Securities sold under agreements to repurchase | 4,449,665 | 4,454,661 |
| Customer payables | 5,830,257 | 4,964,922 |
| FHLB advances and other borrowings | 1,285,011 | 1,260,916 |
| Corporate debt | 1,767,749 | 1,764,982 |
| Other liabilities | <u>1,515,426</u> | <u>1,644,236</u> |
| Total liabilities | <u>40,717,905</u> | <u>42,482,269</u> |
| Commitments and contingencies (see Note 15) | | |
| Shareholders' equity: | | |
| Common stock, \$0.01 par value, shares authorized: 400,000,000 at September 30, 2013 and December 31, 2012, shares issued and outstanding: 287,182,972 at September 30, 2013 and 286,114,334 at December 31, 2012 | 2,872 | 2,861 |
| Additional paid-in-capital ("APIC") | 7,326,891 | 7,319,257 |
| Accumulated deficit | (2,079,571) | (2,107,720) |
| Accumulated other comprehensive loss | <u>(420,618)</u> | <u>(309,928)</u> |
| Total shareholders' equity | <u>4,829,574</u> | <u>4,904,470</u> |
| Total liabilities and shareholders' equity | <u>\$45,547,479</u> | <u>\$47,386,739</u> |

See accompanying notes to the consolidated financial statements

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

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|--|----------------|-----------------|----------------------------------|------------------------|---|----------------------------------|
| | Shares | Amount | | | | |
| Balance, December 31, 2012 | 286,114 | \$ 2,861 | \$ 7,319,257 | \$ (2,107,720) | \$ (309,928) | \$ 4,904,470 |
| Net income | — | — | — | 28,149 | — | 28,149 |
| Other comprehensive loss | — | — | — | — | (110,690) | (110,690) |
| Conversion of convertible debentures | — | — | 1 | — | — | 1 |
| Exercise of stock options and related tax effects | 102 | 1 | (6,073) | — | — | (6,072) |
| Issuance of restricted stock, net of forfeitures and retirements to pay taxes | 967 | 10 | (6,703) | — | — | (6,693) |
| Share-based compensation | — | — | 20,409 | — | — | 20,409 |
| Balance, September 30, 2013 | <u>287,183</u> | <u>\$ 2,872</u> | <u>\$ 7,326,891</u> | <u>\$ (2,079,571)</u> | <u>\$ (420,618)</u> | <u>\$ 4,829,574</u> |

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|--|----------------|-----------------|----------------------------------|------------------------|---|----------------------------------|
| | Shares | Amount | | | | |
| Balance, December 31, 2011 | 285,368 | \$ 2,854 | \$ 7,306,862 | \$ (1,995,137) | \$ (386,629) | \$ 4,927,950 |
| Net income | — | — | — | 73,476 | — | 73,476 |
| Other comprehensive income | — | — | — | — | 83,226 | 83,226 |
| Conversion of convertible debentures | 10 | — | 100 | — | — | 100 |
| Exercise of stock options and related tax effects | 2 | — | (4,428) | — | — | (4,428) |
| Issuance of restricted stock, net of forfeitures and retirements to pay taxes | 676 | 7 | (3,581) | — | — | (3,574) |
| Share-based compensation | — | — | 17,097 | — | — | 17,097 |
| Other | — | — | 7 | — | — | 7 |
| Balance, September 30, 2012 | <u>286,056</u> | <u>\$ 2,861</u> | <u>\$ 7,316,057</u> | <u>\$ (1,921,661)</u> | <u>\$ (303,403)</u> | <u>\$ 5,093,854</u> |

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|----------------------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net income | \$ 28,149 | \$ 73,476 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 126,198 | 280,227 |
| Depreciation and amortization (including discount amortization and accretion) | 311,284 | 300,608 |
| Net impairment and gains on loans and securities, net | (46,623) | (127,372) |
| Impairment of goodwill | 142,423 | — |
| Equity in income (loss) of investments and other | (5,127) | (1,791) |
| Losses on early extinguishment of debt | — | 50,608 |
| Share-based compensation | 20,409 | 17,097 |
| Deferred taxes | 59,715 | 179,066 |
| Other | 2,095 | (133) |
| Net effect of changes in assets and liabilities: | | |
| Increase in cash required to be segregated under federal or other regulations | (361,323) | (158,743) |
| Increase in margin receivables | (384,667) | (781,997) |
| Increase in customer payables | 865,335 | 422,782 |
| Proceeds from sales of loans held-for-sale | 5,364 | 284,083 |
| Originations of loans held-for-sale | — | (286,932) |
| Net decrease (increase) in trading securities | 17 | (52,922) |
| Decrease in other assets | 254,356 | 179,486 |
| Decrease in other liabilities | (129,106) | (19,061) |
| Net cash provided by operating activities | <u>888,499</u> | <u>358,482</u> |
| Cash flows from investing activities: | | |
| Purchases of available-for-sale securities | (5,432,676) | (8,361,692) |
| Proceeds from sales, maturities of and principal payments on available-for-sale securities | 5,189,935 | 9,305,899 |
| Purchases of held-to-maturity securities | (2,032,297) | (4,414,929) |
| Proceeds from maturities of and principal payments on held-to-maturity securities | 1,579,089 | 781,414 |
| Net decrease in loans receivable | 1,315,658 | 1,335,623 |
| Capital expenditures for property and equipment | (31,282) | (65,823) |
| Proceeds from sale of REO and repossessed assets | 53,334 | 81,149 |
| Net cash flow from derivatives hedging assets | 10,821 | (71,178) |
| Other | 6,000 | 9,240 |
| Net cash provided by (used in) investing activities | <u>\$ 658,582</u> | <u>\$(1,400,297)</u> |

See accompanying notes to the consolidated financial statements

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

| | Nine Months Ended September 30, | |
|---|------------------------------------|---------------------|
| | 2013 | 2012 |
| Cash flows from financing activities: | | |
| Net (decrease) increase in deposits | \$(2,522,757) | \$ 2,666,726 |
| Net decrease in securities sold under agreements to repurchase | (4,996) | (406,382) |
| Advances from FHLB | 1,010,000 | 2,460,000 |
| Payments on advances from FHLB | (1,010,000) | (2,880,000) |
| Net cash flow from derivatives hedging liabilities | 4,454 | (18,864) |
| Other | 10,905 | (54,492) |
| Net cash (used in) provided by financing activities | <u>(2,512,394)</u> | <u>1,766,988</u> |
| (Decrease) increase in cash and equivalents | (965,313) | 725,173 |
| Cash and equivalents, beginning of period | 2,761,494 | 2,099,839 |
| Cash and equivalents, end of period | <u>\$ 1,796,181</u> | <u>\$ 2,825,012</u> |
| Supplemental disclosures: | | |
| Cash paid for interest | \$ 180,303 | \$ 258,748 |
| Cash paid for income taxes | \$ 2,938 | \$ 6,194 |
| Non-cash investing and financing activities: | | |
| Reclassification of market making business assets and liabilities to business held-for-sale | \$ 78,978 | \$ — |
| Reclassification of loans held-for-investment to loans held-for-sale | \$ 41,102 | \$ — |
| Transfers from loans to other real estate owned and repossessed assets | \$ 58,969 | \$ 101,460 |
| Conversion of convertible debentures to common stock | \$ 1 | \$ 100 |

See accompanying notes to the consolidated financial statements

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

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

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

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

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

At the end of June 2013, the Company decided to exit its market making business, and reclassified the assets and liabilities of the market making business to held-for-sale. The assets and liabilities of the market making business are presented in the other assets and other liabilities line items, respectively, as of September 30, 2013 on the consolidated balance sheet.

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

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

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

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Related Parties—Kenneth Griffin, President and CEO of Citadel, served on the Company’s Board of Directors from June 8, 2009 to May 9, 2013. During this period, the Company routed a portion of its customer equity orders in exchange-listed options and Regulation NMS Securities to an affiliate of Citadel for order handling and execution at current market rates. Payments for these customer equity orders represented less than 1% of the Company’s total net revenue for both the three and nine months ended September 30, 2013 and 2012.

Joseph M. Velli, Chairman and CEO of ConvergEx Group, joined the Board of Directors in January 2010. During the periods presented, the Company used ConvergEx Group for clearing and transfer agent services. Payments for these services represented less than 1% of the Company’s total operating expenses for both the three and nine months ended September 30, 2013 and 2012.

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

Financial Statement Descriptions and Related Accounting Policies

Margin Receivables—The fair value of securities that the Company received as collateral in connection with margin receivables and securities borrowing activities, where the Company is permitted to sell or re-pledge the securities, was approximately \$8.7 billion and \$8.2 billion as of September 30, 2013 and December 31, 2012, respectively. Of this amount, \$1.7 billion and \$1.5 billion had been pledged or sold in connection with securities loans, bank borrowings and deposits with clearing organizations as of September 30, 2013 and December 31, 2012, respectively.

Allowance for Loan Losses—The allowance for loan losses is management’s estimate of probable losses inherent in the loan portfolio as of the balance sheet date. The Company’s segments are one- to four-family, home equity and consumer and other. For loans that are not TDRs, the Company established a general allowance. 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; the Company’s 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 one- to four-family and home equity loan portfolios are separated into risk segments based on key risk factors, which include but are not limited to loan type, delinquency history, documentation type, LTV/CLTV ratio and borrowers’ credit scores. 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. Both current CLTV and FICO scores are among the factors utilized to categorize the risk associated with loans and assign a probability assumption of future default. Based upon the segmentation, the Company utilizes historical performance data to develop the forecast of delinquency and default for these risk segments. During the three and nine months ended September 30, 2013, the Company evaluated and refined its default assumptions related to a subset of the home equity line of credit portfolio that will require borrowers to repay the loan in full at the end of the draw period, commonly referred to as “balloon loans”. These loans were approximately \$250 million of the home equity line of credit portfolio at September 30, 2013. The Company evaluated the significant burden a balloon payment may place on a borrower with a low FICO score and high CLTV ratio, and examined those loans within the balloon portfolio. The Company refined its expectations and estimates around the time period that it might take for these

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borrowers' equity positions in their collateral to appreciate in order to allow for possible refinance of the balloon loan at maturity. As a result of this evaluation, the Company increased its default assumptions and extended the period of management's forecasted loan losses captured within the general allowance to include the total probable loss on this subset of balloon loans. The overall impact of these enhancements drove the majority of provision for loan losses during the three and nine months ended September 30, 2013. The Company's consumer and other loan portfolio is separated into risk segments by product and delinquency status. The Company utilizes historical performance data and historical recovery rates on collateral liquidation to forecast delinquency and loss at the product level. The general allowance for loan losses is typically equal to management's forecast of loan losses in the twelve months following the balance sheet date.

The general allowance for loan losses also included a qualitative component to account for a variety of factors that are not directly considered in the quantitative loss model but are factors the Company believes may impact the level of credit losses. Examples of these factors are: external factors, such as changes in the macroeconomic, legal and regulatory environment; internal factors, such as procedural changes and reliance on third parties; and portfolio specific factors, such as the impact of payment resets and historical loan modification activity, which impacts the historical performance data used to forecast delinquency and default in the general allowance for loan losses.

The total qualitative component was \$52 million and \$44 million at September 30, 2013 and December 31, 2012, respectively. The qualitative component for the one- to four-family and home equity loan portfolios was 19% and 17% of the general allowance for loan losses at September 30, 2013 and December 31, 2012, respectively. The increase in the qualitative reserve in these loan portfolios from December 31, 2012 to September 30, 2013 primarily reflects updates to portfolio specific factors. The qualitative component for the consumer and other loan portfolio was 16% and 17% of the general allowance at September 30, 2013 and December 31, 2012, respectively.

For modified loans accounted for as TDRs that are valued using the discounted cash flow model, the Company established a specific allowance. The specific allowance for TDRs factors in the historical default rate of an individual loan before being modified as a TDR in the discounted cash flow analysis in order to determine that specific loan's expected impairment. Specifically, a loan that has a more severe delinquency history prior to modification will have a higher future default rate in the discounted cash flow analysis than a loan that was not as severely delinquent. For both of the one- to four-family and home equity loan portfolio segments, the pre-modification delinquency status, the borrower's current credit score and other credit bureau attributes, in addition to each loan's individual default experience and credit characteristics, are incorporated into the calculation of the specific allowance. A specific allowance is established to the extent that the recorded investment exceeds the discounted cash flows of a TDR with a corresponding charge to provision for loan losses. The specific allowance for these individually impaired loans represents the forecasted losses over the estimated remaining life of the loan, including the economic concession to the borrower.

Income Taxes—The Company's unrecognized tax benefit decreased \$157.4 million to \$334.6 million during the nine months ended September 30, 2013. The majority of the decrease was due to the Company's ability to carryback 2012 operating losses to 2010 and 2011. At September 30, 2013, \$243.9 million (net of federal benefits on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably impact the effective income tax rate in future periods.

Offsetting Assets and Liabilities—Effective January 1, 2013, the Company adopted the amended disclosure guidance about offsetting certain assets and liabilities, which required additional information about derivative instruments, repurchase agreements and securities borrowing and securities lending transactions that are offset or subject to an enforceable master netting arrangement or similar agreement. For financial statement purposes, the Company does not offset derivative instruments, repurchase agreements or securities borrowing and securities lending transactions. The Company's derivative instruments, repurchase agreements and securities borrowing and securities lending transactions are transacted under master agreements that are widely used by counterparties

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and that may allow for net settlements of payments in the normal course as well as offsetting of all contracts with a given counterparty in the event of bankruptcy or default of one of the two parties to the transaction; therefore, all of these transactions are presented in the amended disclosures. The following table presents information about these transactions to enable the users of the Company's financial statements to evaluate the potential effect of rights of setoff between these recognized assets and recognized liabilities as of September 30, 2013 and December 31, 2012 (dollars in thousands):

| | Gross Amounts of Recognized Assets and Liabilities | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts Presented in the Consolidated Balance Sheet | <u>Gross Amounts Not Offset in the Consolidated Balance Sheet</u> | | Net Amount |
|---|---|---|--|---|--|------------------|
| | | | | Financial Instruments | Collateral Received or Pledged (Including Cash) | |
| September 30, 2013 | | | | | | |
| Assets: | | | | | | |
| Deposits paid for securities borrowed ⁽¹⁾⁽⁵⁾ | \$ 422,737 | \$ — | \$ 422,737 | \$(132,104) | \$ (280,871) | \$ 9,762 |
| Derivative assets ⁽¹⁾⁽³⁾ | 79,955 | — | 79,955 | (44,651) | (16,129) | 19,175 |
| Total | <u>\$ 502,692</u> | <u>\$ —</u> | <u>\$ 502,692</u> | <u>\$(176,755)</u> | <u>\$ (297,000)</u> | <u>\$ 28,937</u> |
| Liabilities: | | | | | | |
| Repurchase agreements ⁽⁴⁾ | \$ 4,449,665 | \$ — | \$ 4,449,665 | \$ — | \$ (4,449,417) | \$ 248 |
| Deposits received for securities loaned ⁽²⁾⁽⁶⁾ | 831,830 | — | 831,830 | (132,104) | (643,038) | 56,688 |
| Derivative liabilities ⁽²⁾⁽³⁾⁽⁴⁾ | 206,585 | — | 206,585 | (44,651) | (161,934) | — |
| Total | <u>\$ 5,488,080</u> | <u>\$ —</u> | <u>\$ 5,488,080</u> | <u>\$(176,755)</u> | <u>\$ (5,254,389)</u> | <u>\$ 56,936</u> |
| December 31, 2012 | | | | | | |
| Assets: | | | | | | |
| Deposits paid for securities borrowed ⁽¹⁾⁽⁵⁾ | \$ 407,331 | \$ — | \$ 407,331 | \$(142,410) | \$ (259,490) | \$ 5,431 |
| Derivative assets ⁽¹⁾⁽³⁾ | 14,734 | — | 14,734 | (5,176) | (8,427) | 1,131 |
| Total | <u>\$ 422,065</u> | <u>\$ —</u> | <u>\$ 422,065</u> | <u>\$(147,586)</u> | <u>\$ (267,917)</u> | <u>\$ 6,562</u> |
| Liabilities: | | | | | | |
| Repurchase agreements ⁽⁴⁾ | \$ 4,454,661 | \$ — | \$ 4,454,661 | \$ — | \$ (4,454,659) | \$ 2 |
| Deposits received for securities loaned ⁽²⁾⁽⁶⁾ | 735,720 | — | 735,720 | (142,410) | (554,400) | 38,910 |
| Derivative liabilities ⁽²⁾⁽³⁾⁽⁴⁾ | 328,464 | — | 328,464 | (5,176) | (323,288) | — |
| Total | <u>\$ 5,518,845</u> | <u>\$ —</u> | <u>\$ 5,518,845</u> | <u>\$(147,586)</u> | <u>\$ (5,332,347)</u> | <u>\$ 38,912</u> |

(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 \$22.5 million and \$14.1 million as of September 30, 2013 and December 31, 2012, respectively.

(4) The Company pledges available-for-sale and held-to-maturity securities as collateral for amounts due on repurchase agreements and derivative liabilities. The collateral pledged included available-for-sale securities at fair value and held-to-maturity securities at amortized cost for both September 30, 2013 and December 31, 2012.

(5) Included in the gross amounts of deposits paid for securities borrowed is \$264.7 million and \$133.8 million as of September 30, 2013 and December 31, 2012, respectively, transacted through a program with a clearing organization, which guarantees the return of cash to the Company. For presentation purposes, these amounts presented are based on the original counterparties to the Company's master securities loan agreements.

(6) Included in the gross amounts of deposits received for securities loaned is \$538.3 million and \$419.6 million as of September 30, 2013 and December 31, 2012, respectively, transacted through a program with a clearing organization, which guarantees the return of securities to the Company. For presentation purposes, these amounts presented are based on the original counterparties to the Company's master securities loan agreements.

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

Disclosures about Offsetting Assets and Liabilities

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

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the FASB amended the presentation guidance on the reporting of amounts reclassified out of accumulated other comprehensive income. The amended guidance does not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the guidance amends the presentation of the amounts reclassified out of accumulated other comprehensive income by component. In addition, the amended guidance requires the presentation, either on the face of the statement where net income is presented or in the notes, of significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amended guidance became effective for annual and interim periods beginning on January 1, 2013 for the Company and was applied prospectively. The Company's disclosures reflect the adoption of the amended presentation guidance in Note 12—Shareholders' Equity.

Inclusion of the Fed Funds Effective Swap Rate as a Benchmark Interest Rate for Hedge Accounting Purposes

In July 2013, the FASB amended the derivatives and hedging accounting guidance. The amended guidance permits the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes under derivatives and hedging accounting requirements, in addition to U.S. Treasury and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. Before the amendments, only U.S. Treasury and the LIBOR swap rate were considered benchmark interest rates in accordance with GAAP. The amendments became effective prospectively for qualifying new or re-designated hedging relationships entered into on or after July 17, 2013. The amended accounting guidance did not have a material impact on the Company's statement of financial condition, results of operation, or cash flows.

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

In July 2013, the FASB amended the presentation guidance on unrecognized tax benefits. The amended guidance requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except under certain circumstances. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The unrecognized tax benefit should also be presented in the financial statements as a liability if the tax law of the applicable jurisdiction does not require the Company to use, and the Company does not intend to use, the deferred tax asset to settle any additional income taxes. The amended presentation guidance will be effective for annual and interim periods beginning on January 1, 2014 for the

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Company and will be applied prospectively to unrecognized tax benefits that exist at that date. Retrospective application and early adoption is permitted. The adoption of the amended presentation guidance will not have a material impact on the Company's financial condition, results of operations, or cash flows.

NOTE 2—BUSINESS HELD-FOR-SALE

Exit of Market Making Business

At the end of June 2013, the Company approved a plan to exit its market making business, and as a result the market making business' assets and liabilities were classified as held-for-sale. The table below summarizes the carrying amounts of the major classes of assets and liabilities of the market making business as of September 30, 2013 and December 31, 2012 (dollars in thousands):

| | September 30, 2013 ⁽¹⁾ | December 31, 2012 |
|-----------------------------|--------------------------------------|-------------------------|
| Assets | | |
| Cash and equivalents | \$ 9,336 | \$ 7,618 |
| Trading securities | 97,548 | 101,252 |
| Property and equipment, net | 1,112 | 1,517 |
| Goodwill | — | 142,423 |
| Other intangibles, net | 21,161 | 21,898 |
| Other assets | 47,071 | 37,096 |
| Total assets | <u>\$ 176,228</u> | <u>\$311,804</u> |
| Liabilities | | |
| Other liabilities | 102,448 | 96,463 |
| Total liabilities | <u>\$ 102,448</u> | <u>\$ 96,463</u> |

⁽¹⁾ Assets and liabilities as of September 30, 2013 are classified as held-for-sale and reflected in the other assets and other liabilities line items on the consolidated balance sheet, respectively.

As a result of the Company's decision to exit the market making business, the goodwill associated with the market making business was impaired. For additional information on the impairment of goodwill, see Note 8—Goodwill.

NOTE 3—OPERATING INTEREST INCOME AND OPERATING INTEREST EXPENSE

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------------|------------------------------------|-------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Operating interest income: | | | | |
| Loans | \$ 96,365 | \$ 118,747 | \$ 305,222 | \$ 383,242 |
| Available-for-sale securities | 68,470 | 82,661 | 199,029 | 286,647 |
| Held-to-maturity securities | 64,486 | 61,923 | 183,819 | 175,574 |
| Margin receivables | 56,073 | 55,465 | 164,459 | 158,873 |
| Securities borrowed and other | 15,521 | 15,181 | 50,276 | 46,422 |
| Total operating interest income | <u>300,915</u> | <u>333,977</u> | <u>902,805</u> | <u>1,050,758</u> |
| Operating interest expense: | | | | |
| Securities sold under agreements to repurchase | (37,431) | (40,136) | (111,144) | (121,373) |
| FHLB advances and other borrowings | (17,152) | (24,153) | (51,183) | (74,979) |
| Deposits | (3,306) | (5,885) | (9,680) | (20,838) |
| Customer payables and other | (2,179) | (2,926) | (6,081) | (8,734) |
| Total operating interest expense | <u>(60,068)</u> | <u>(73,100)</u> | <u>(178,088)</u> | <u>(225,924)</u> |
| Net operating interest income | <u>\$240,847</u> | <u>\$260,877</u> | <u>\$ 724,717</u> | <u>\$ 824,834</u> |

NOTE 4—FAIR VALUE DISCLOSURES

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

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

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

Recurring Fair Value Measurement Techniques

U.S. Treasury Securities and Agency Debentures

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

Residential Mortgage-backed Securities

The Company's residential mortgage-backed securities portfolio was comprised of agency mortgage-backed securities and CMOs, which represented the majority of the portfolio, and non-agency CMOs. Agency mortgage-backed securities and CMOs are guaranteed by U.S. government sponsored and federal agencies. All of the Company's non-agency CMOs were backed by first lien mortgages and were below investment grade or non-rated as of September 30, 2013. The weighted average coupon rates for the residential mortgage-backed securities as of September 30, 2013 are shown in the following table:

| | Weighted Average Coupon Rate |
|-----------------------------------|---|
| Agency mortgage-backed securities | 3.10% |
| Agency CMOs | 3.28% |
| Non-agency CMOs | 3.14% |

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

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Non-agency CMOs were valued using market and income approaches with market observable data, including recent market transactions when available. The valuations of non-agency CMOs reflect the Company's best estimate of what market participants would consider in pricing the financial instruments. The Company considers the price transparency for non-agency CMOs to be a key determinant of the degree of judgment involved in determining the fair value. As of September 30, 2013, the Company's non-agency CMOs were categorized in Level 3 of the fair value hierarchy. The Company's portfolio management group determines the fair value measurements using a discounted cash flow methodology for non-agency CMOs on a monthly basis with market observable data to the extent available. The fair value measurements, valuation techniques and level classification methodology are reviewed and compared to prior periods on a quarterly basis by management from the finance, credit, enterprise risk management and compliance departments.

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

The following table presents additional information about the underlying loans and significant inputs used in discounted cash flow methodologies for the valuation of non-agency CMOs that were categorized in Level 3 of the fair value hierarchy as of September 30, 2013:

| | Weighted Average | Range |
|-----------------------------|---------------------|---------------|
| Underlying loans: | | |
| Coupon rate | 2.86% | 2.72% - 6.28% |
| Maturity (years) | 20 | 20 - 25 |
| Significant inputs: | | |
| Yield | 3% | 3% - 10% |
| Default rate ⁽¹⁾ | 32% | 3% - 100% |
| Loss severity | 28% | 0% - 65% |
| Prepayment rate | 13% | 4% - 39% |

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

Other Debt Securities

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

The Company's municipal bonds are revenue bonds issued by state and other local government agencies. The valuation of corporate bonds is impacted by the credit worthiness of the corporate issuer. All of the Company's municipal bonds and corporate bonds were rated investment grade as of September 30, 2013. These securities were valued using a market approach with pricing service valuations corroborated by recent market transactions for identical or similar bonds. Municipal bonds and corporate bonds were categorized in Level 2 of the fair value hierarchy.

Derivative Instruments

Interest rate swap and option contracts were valued with an income approach using pricing models that are commonly used by the financial services industry. The market observable inputs used in the pricing models include the swap curve, the volatility surface, and prime or overnight indexed swap basis from a financial data

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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.

Securities Owned and Securities Sold, Not Yet Purchased

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

Nonrecurring Fair Value Measurement Techniques

Loans Receivable and REO

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

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

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

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

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The following table presents additional information about significant unobservable inputs used in the valuation of assets measured at fair value on a nonrecurring basis that were categorized in Level 3 of the fair value hierarchy as of September 30, 2013 (dollars in thousands):

| | <u>Unobservable Inputs</u> | <u>Average</u> | <u>Range</u> |
|---------------------|----------------------------|----------------|----------------|
| One- to four-family | Appraised value | \$ 387 | \$ 4 — \$2,500 |
| Home equity | Appraised value | \$ 290 | \$ 9 — \$1,600 |
| Real estate owned | Appraised value | \$ 285 | \$ 1 — \$1,163 |

Goodwill

At the end of the second quarter of 2013, the Company decided to exit the market making business, and as a result evaluated the total goodwill allocated to the market making reporting unit for impairment. The Company valued the market making business by using a combination of expected present value of future cash flows of the business, a form of the income approach, and prices of comparable businesses, a form of the market approach, with significant unobservable inputs. The Company refined the estimated fair value of the market making reporting unit using the expected sale structure of the market making business. As a result of the evaluation, it was determined that the entire carrying amount of goodwill allocated to the market making reporting unit was impaired, and the Company recognized \$142.4 million impairment of goodwill during the second quarter of 2013.

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Recurring and Nonrecurring Fair Value Measurements

Assets and liabilities measured at fair value at September 30, 2013 and December 31, 2012 are summarized in the following tables (dollars in thousands):

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total Fair Value</u> |
|--|-------------------|----------------------|-------------------|-------------------------|
| September 30, 2013: | | | | |
| Recurring fair value measurements: | | | | |
| Assets | | | | |
| Available-for-sale securities: | | | | |
| Residential mortgage-backed securities: | | | | |
| Agency mortgage-backed securities and CMOs | \$ — | \$ 12,222,556 | \$ — | \$ 12,222,556 |
| Non-agency CMOs | — | — | 14,012 | 14,012 |
| Total residential mortgage-backed securities | — | 12,222,556 | 14,012 | 12,236,568 |
| Investment securities: | | | | |
| Agency debentures | — | 318,354 | — | 318,354 |
| Agency debt securities | — | 675,531 | — | 675,531 |
| Municipal bonds | — | 46,550 | — | 46,550 |
| Corporate bonds | — | 4,455 | — | 4,455 |
| Total investment securities | — | 1,044,890 | — | 1,044,890 |
| Total available-for-sale securities | — | 13,267,446 | 14,012 | 13,281,458 |
| Other assets: | | | | |
| Derivative assets ⁽¹⁾ | — | 79,955 | — | 79,955 |
| Deposits with clearing organizations ⁽²⁾ | 34,000 | — | — | 34,000 |
| Held-for-sale assets—trading securities ⁽³⁾ | 96,393 | 1,155 | — | 97,548 |
| Total other assets measured at fair value on a recurring basis | 130,393 | 81,110 | — | 211,503 |
| Total assets measured at fair value on a recurring basis ⁽⁴⁾ | <u>\$ 130,393</u> | <u>\$ 13,348,556</u> | <u>\$ 14,012</u> | <u>\$ 13,492,961</u> |
| Liabilities | | | | |
| Derivative liabilities ⁽¹⁾ | \$ — | \$ 206,585 | \$ — | \$ 206,585 |
| Held-for-sale liabilities—securities sold, not yet purchased ⁽³⁾ | 93,147 | 122 | — | 93,269 |
| Total liabilities measured at fair value on a recurring basis ⁽⁴⁾ | <u>\$ 93,147</u> | <u>\$ 206,707</u> | <u>\$ —</u> | <u>\$ 299,854</u> |
| Nonrecurring fair value measurements: | | | | |
| Loans receivable: | | | | |
| One- to four-family | \$ — | \$ — | \$ 213,972 | \$ 213,972 |
| Home equity | — | — | 46,718 | 46,718 |
| Total loans receivable ⁽⁵⁾ | — | — | 260,690 | 260,690 |
| REO ⁽⁵⁾ | — | — | 45,060 | 45,060 |
| Total assets measured at fair value on a nonrecurring basis ⁽⁶⁾ | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 305,750</u> | <u>\$ 305,750</u> |

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

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

(3) Assets and liabilities of the market making business were reclassified as held-for-sale, and are presented in the other assets and other liabilities line items, respectively, as of September 30, 2013 on the consolidated balance sheet. Information related to the classification is detailed in Note 2—Business Held-for-Sale.

(4) Assets and liabilities measured at fair value on a recurring basis represented 30% and 1% of the Company's total assets and total liabilities, respectively.

(5) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet as of September 30, 2013, and for which a fair value measurement was recorded during the period.

(6) Goodwill allocated to the market making reporting unit with a carrying amount of \$142.4 million was written down to zero during the nine months ended September 30, 2013 and categorized in Level 3 of the fair value hierarchy.

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

- (1) The majority of derivative assets and liabilities are interest rate contracts. Information related to derivative instruments is detailed in Note 7—Accounting for Derivative Instruments and Hedging Activities.
- (2) Represents U.S. Treasury securities held by a broker-dealer subsidiary.
- (3) Assets and liabilities measured at fair value on a recurring basis represented 29% and 1% of the Company's total assets and total liabilities, respectively.
- (4) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet as of December 31, 2012, and for which a fair value measurement was recorded during the period.

The following table presents the losses associated with the assets measured at fair value on a nonrecurring basis during the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| One- to four-family | \$10,107 | \$ 32,465 | \$ 34,480 | \$167,220 |
| Home equity | 10,736 | 70,999 | 46,785 | 265,764 |
| Total losses on loans receivable measured at fair value | \$20,843 | \$103,464 | \$ 81,265 | \$432,984 |
| (Gains) losses on REO measured at fair value | \$ (1,925) | \$ 3,016 | \$ (166) | \$ 11,033 |
| Losses on goodwill measured at fair value | \$ — | \$ — | \$142,423 | \$ — |

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Transfers Between Levels 1 and 2

For assets and liabilities measured at fair value on a recurring basis, the Company's transfers between levels of the fair value hierarchy are deemed to have occurred at the beginning of the reporting period on a quarterly basis. The Company's transfers of securities owned and securities sold, not yet purchased between Level 1 and 2 are generally driven by trading activities of those securities during the period. The Company had no material transfers between Level 1 and 2 during the three and nine months ended September 30, 2013 and 2012.

Level 3 Rollforward for Recurring Fair Value Measurements

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

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| | <u>Available-for-sale Securities</u> <u>Non-agency CMOs</u> |
|---|--|
| Opening balance, July 1, 2013 | \$ 13,793 |
| Losses recognized in earnings ⁽¹⁾ | (586) |
| Net gains recognized in other comprehensive income ⁽²⁾ | 1,401 |
| Settlements | (596) |
| Closing balance, September 30, 2013 | <u>\$ 14,012</u> |

(1) Losses recognized in earnings were related to instruments held at September 30, 2013 and are reported in the net impairment line item.

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

| | <u>Available-for-sale Securities</u> <u>Non-agency CMOs</u> |
|---|--|
| Opening balance, July 1, 2012 | \$ 90,594 |
| Losses recognized in earnings ⁽¹⁾ | (2,318) |
| Net gains recognized in other comprehensive income ⁽²⁾ | 7,773 |
| Settlements | (11,965) |
| Transfer in to Level 3 ⁽³⁾⁽⁴⁾ | 89,357 |
| Transfer out of Level 3 ⁽³⁾⁽⁵⁾ | (31,292) |
| Closing balance, September 30, 2012 | <u>\$ 142,149</u> |

(1) Losses recognized in earnings were related to instruments held at September 30, 2012 and are reported in the net impairment line item.

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

(3) The Company's transfers in and out of Level 3 are as of the beginning of the reporting period on a quarterly basis.

(4) Non-agency CMOs transferred in to Level 3 due to a lack of observable market data, resulting from a decrease in market activity for the securities.

(5) Non-agency CMOs transferred out of Level 3 because observable market data became available for those securities.

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| | <u>Available-for-sale Securities</u> <u>Non-agency CMOs</u> |
|---|--|
| Opening balance, January 1, 2013 | \$ 49,495 |
| Losses recognized in earnings ⁽¹⁾ | (2,331) |
| Net gains recognized in other comprehensive income ⁽²⁾ | 4,160 |
| Sales | (34,949) |
| Settlements | (2,363) |
| Closing balance, September 30, 2013 | <u>\$ 14,012</u> |

(1) Losses recognized in earnings were related to instruments held at September 30, 2013 and are reported in the net impairment line item.

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

| | <u>Available-for-sale Securities</u> <u>Non-agency CMOs</u> |
|---|--|
| Opening balance, January 1, 2012 | \$ 97,106 |
| Losses recognized in earnings ⁽¹⁾ | (8,920) |
| Net gains recognized in other comprehensive income ⁽²⁾ | 12,217 |
| Settlements | (19,246) |
| Transfers in to Level 3 ⁽³⁾⁽⁴⁾ | 177,244 |
| Transfers out of Level 3 ⁽³⁾⁽⁵⁾ | (116,252) |
| Closing balance, September 30, 2012 | <u>\$ 142,149</u> |

(1) Losses recognized in earnings were related to instruments held at September 30, 2012 and are reported in the net impairment line item.

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

(3) The Company's transfers in and out of Level 3 are as of the beginning of the reporting period on a quarterly basis.

(4) Non-agency CMOs transferred in to Level 3 due to a lack of observable market data, resulting from a decrease in market activity for the securities.

(5) Non-agency CMOs transferred out of Level 3 because observable market data became available for those securities.

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The Company's transfers of certain non-agency CMOs in and out of Level 3 are generally driven by changes in price transparency for the securities. Financial instruments for which actively quoted prices or pricing parameters are available will have a higher degree of price transparency than financial instruments that are thinly traded or not quoted. As of September 30, 2013, less than 1% of the Company's total assets and none of its total liabilities represented instruments measured at fair value on a recurring basis categorized as Level 3.

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 September 30, 2013 and December 31, 2012 (dollars in thousands):

| | September 30, 2013 | | | | Total Fair Value |
|---|---------------------|-------------|---------------------|--------------------|---------------------|
| | Carrying Value | Level 1 | Level 2 | Level 3 | |
| Assets | | | | | |
| Cash and equivalents | \$ 1,796,181 | \$1,796,181 | \$ — | \$ — | \$ 1,796,181 |
| Cash required to be segregated under federal or other regulations | \$ 738,221 | \$ 738,221 | \$ — | \$ — | \$ 738,221 |
| Held-to-maturity securities: | | | | | |
| Agency mortgage-backed securities and CMOs | \$ 8,255,442 | \$ — | \$ 8,285,373 | \$ — | \$ 8,285,373 |
| Agency debentures | 163,448 | — | 168,290 | — | 168,290 |
| Agency debt securities | 1,525,263 | — | 1,523,710 | — | 1,523,710 |
| Total held-to-maturity securities | <u>\$ 9,944,153</u> | <u>\$ —</u> | <u>\$ 9,977,373</u> | <u>\$ —</u> | <u>\$ 9,977,373</u> |
| Margin receivables | \$ 6,188,708 | \$ — | \$ 6,188,708 | \$ — | \$ 6,188,708 |
| Loans receivable, net: | | | | | |
| One- to four-family | \$ 4,619,656 | \$ — | \$ — | \$3,903,292 | \$ 3,903,292 |
| Home equity | 3,324,010 | — | — | 3,006,621 | 3,006,621 |
| Consumer and other | 620,948 | — | — | 635,279 | 635,279 |
| Total loans receivable, net ⁽¹⁾ | <u>\$ 8,564,614</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$7,545,192</u> | <u>\$ 7,545,192</u> |
| Investment in FHLB stock | \$ 61,400 | \$ — | \$ — | \$ 61,400 | \$ 61,400 |
| Liabilities | | | | | |
| Deposits | \$25,869,797 | \$ — | \$25,870,010 | \$ — | \$ 25,870,010 |
| Securities sold under agreement to repurchase | \$ 4,449,665 | \$ — | \$ 4,480,874 | \$ — | \$ 4,480,874 |
| Customer payables | \$ 5,830,257 | \$ — | \$ 5,830,257 | \$ — | \$ 5,830,257 |
| FHLB advances and other borrowings | \$ 1,285,011 | \$ — | \$ 935,296 | \$ 210,733 | \$ 1,146,029 |
| Corporate debt | \$ 1,767,749 | \$ — | \$ 1,903,587 | \$ — | \$ 1,903,587 |

(1) The carrying value of loans receivable, net includes the allowance for loan losses of \$458.9 million and loans that are valued at fair value on a nonrecurring basis as of September 30, 2013.

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

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

The fair value measurement techniques for financial instruments not carried at fair value on the consolidated balance sheet at September 30, 2013 and December 31, 2012 are summarized as follows:

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

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

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

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

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

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

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

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

NOTE 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 September 30, 2013 and December 31, 2012 are shown in the following tables (dollars in thousands):

| | Amortized Cost | Gross Unrealized / Unrecognized Gains | Gross Unrealized / Unrecognized Losses | Fair Value |
|--|---------------------|--|---|---------------------|
| September 30, 2013: | | | | |
| Available-for-sale securities: | | | | |
| Residential mortgage-backed securities: | | | | |
| Agency mortgage-backed securities and CMOs | \$12,380,442 | \$ 90,647 | \$ (248,533) | \$12,222,556 |
| Non-agency CMOs | 18,579 | 1,580 | (6,147) | 14,012 |
| Total residential mortgage-backed securities | <u>12,399,021</u> | <u>92,227</u> | <u>(254,680)</u> | <u>12,236,568</u> |
| Investment securities: | | | | |
| Agency debentures | 358,392 | — | (40,038) | 318,354 |
| Agency debt securities | 660,917 | 19,205 | (4,591) | 675,531 |
| Municipal bonds | 49,639 | — | (3,089) | 46,550 |
| Corporate bonds | 5,479 | — | (1,024) | 4,455 |
| Total investment securities | <u>1,074,427</u> | <u>19,205</u> | <u>(48,742)</u> | <u>1,044,890</u> |
| Total available-for-sale securities | <u>\$13,473,448</u> | <u>\$ 111,432</u> | <u>\$ (303,422)</u> | <u>\$13,281,458</u> |
| Held-to-maturity securities: | | | | |
| Residential mortgage-backed securities: | | | | |
| Agency mortgage-backed securities and CMOs | \$ 8,255,442 | \$ 130,073 | \$ (100,142) | \$ 8,285,373 |
| Investment securities: | | | | |
| Agency debentures | 163,448 | 4,842 | — | 168,290 |
| Agency debt securities | 1,525,263 | 20,350 | (21,903) | 1,523,710 |
| Total investment securities | <u>1,688,711</u> | <u>25,192</u> | <u>(21,903)</u> | <u>1,692,000</u> |
| Total held-to-maturity securities | <u>\$ 9,944,153</u> | <u>\$ 155,265</u> | <u>\$ (122,045)</u> | <u>\$ 9,977,373</u> |

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

Contractual Maturities

The contractual maturities of all available-for-sale and held-to-maturity debt securities at September 30, 2013 are shown below (dollars in thousands):

| | Amortized Cost | Fair Value |
|-------------------------------------|----------------------|----------------------|
| Available-for-sale securities: | | |
| Due within one year | \$ 1,788 | \$ 1,794 |
| Due within one to five years | 61,324 | 62,567 |
| Due within five to ten years | 1,380,016 | 1,362,186 |
| Due after ten years | 12,030,320 | 11,854,911 |
| Total available-for-sale securities | <u>\$ 13,473,448</u> | <u>\$ 13,281,458</u> |
| Held-to-maturity securities: | | |
| Due within one year | \$ 55 | \$ 55 |
| Due within one to five years | 685,762 | 715,461 |
| Due within five to ten years | 2,576,559 | 2,612,245 |
| Due after ten years | 6,681,777 | 6,649,612 |
| Total held-to-maturity securities | <u>\$ 9,944,153</u> | <u>\$ 9,977,373</u> |

The Company pledged \$2.2 billion and \$2.8 billion at September 30, 2013 and December 31, 2012, respectively, of available-for-sale securities and \$3.2 billion and \$2.9 billion at September 30, 2013 and December 31, 2012, respectively, of held-to-maturity securities as collateral for repurchase agreements, derivatives and other purposes.

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Investments with Unrecognized or Unrealized Losses

The following tables show the fair value and unrealized or unrecognized losses on available-for-sale and held-to-maturity securities, aggregated by investment category, and the length of time that individual securities have been in a continuous unrealized or unrecognized loss position at September 30, 2013 and December 31, 2012 (dollars in thousands):

| | Less than 12 Months | | 12 Months or More | | Total | |
|--|---------------------|--|-------------------|--|--------------------|--|
| | Fair Value | Unrealized / Unrecognized Losses | Fair Value | Unrealized / Unrecognized Losses | Fair Value | Unrealized / Unrecognized Losses |
| September 30, 2013: | | | | | | |
| Available-for-sale securities: | | | | | | |
| Residential mortgage-backed securities: | | | | | | |
| Agency mortgage-backed securities and CMOs | \$5,634,999 | \$ (240,105) | \$556,432 | \$ (8,428) | \$6,191,431 | \$ (248,533) |
| Non-agency CMOs | — | — | 11,811 | (6,147) | 11,811 | (6,147) |
| Investment securities: | | | | | | |
| Agency debentures | 318,355 | (40,038) | — | — | 318,355 | (40,038) |
| Agency debt securities | 167,591 | (4,591) | — | — | 167,591 | (4,591) |
| Municipal bonds | 46,549 | (3,089) | — | — | 46,549 | (3,089) |
| Corporate bonds | — | — | 4,455 | (1,024) | 4,455 | (1,024) |
| Total temporarily impaired available-for-sale securities | <u>\$6,167,494</u> | <u>\$ (287,823)</u> | <u>\$572,698</u> | <u>\$ (15,599)</u> | <u>\$6,740,192</u> | <u>\$ (303,422)</u> |
| Held-to-maturity securities: | | | | | | |
| Residential mortgage-backed securities: | | | | | | |
| Agency mortgage-backed securities and CMOs | \$3,557,145 | \$ (97,546) | \$134,198 | \$ (2,596) | \$3,691,343 | \$ (100,142) |
| Agency debt securities | 942,536 | (21,903) | — | — | 942,536 | (21,903) |
| Total temporarily impaired held-to-maturity securities | <u>\$4,499,681</u> | <u>\$ (119,449)</u> | <u>\$134,198</u> | <u>\$ (2,596)</u> | <u>\$4,633,879</u> | <u>\$ (122,045)</u> |
| December 31, 2012: | | | | | | |
| Available-for-sale securities: | | | | | | |
| Residential mortgage-backed securities: | | | | | | |
| Agency mortgage-backed securities and CMOs | \$2,588,947 | \$ (16,680) | \$ 16,337 | \$ (112) | \$2,605,284 | \$ (16,792) |
| Non-agency CMOs | — | — | 198,635 | (29,263) | 198,635 | (29,263) |
| Investment securities: | | | | | | |
| Agency debentures | 62,786 | (428) | — | — | 62,786 | (428) |
| Corporate bonds | — | — | 4,455 | (1,023) | 4,455 | (1,023) |
| Total temporarily impaired available-for-sale securities | <u>\$2,651,733</u> | <u>\$ (17,108)</u> | <u>\$219,427</u> | <u>\$ (30,398)</u> | <u>\$2,871,160</u> | <u>\$ (47,506)</u> |
| Held-to-maturity securities: | | | | | | |
| Residential mortgage-backed securities: | | | | | | |
| Agency mortgage-backed securities and CMOs | \$1,240,008 | \$ (6,937) | \$ 2,427 | \$ (240) | \$1,242,435 | \$ (7,177) |
| Agency debt securities | 84 | (1) | — | — | 84 | (1) |
| Total temporarily impaired held-to-maturity securities | <u>\$1,240,092</u> | <u>\$ (6,938)</u> | <u>\$ 2,427</u> | <u>\$ (240)</u> | <u>\$1,242,519</u> | <u>\$ (7,178)</u> |

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The Company does not believe that any individual unrealized loss in the available-for-sale or unrecognized loss in the held-to-maturity portfolio as of September 30, 2013 represents a credit loss. The credit loss component is the difference between the security's amortized cost basis and the present value of its expected future cash flows, and is recognized in earnings. The noncredit loss component is the difference between the present value of its expected future cash flows and the fair value and is recognized through other comprehensive income (loss). The Company assessed whether it intends to sell, or whether it is more likely than not that the Company will be required to sell a security before recovery of its amortized cost basis. For debt securities that are considered other-than-temporarily impaired and that the Company does not intend to sell as of the balance sheet date and will not be required to sell prior to recovery of its amortized cost basis, the Company determines the amount of the impairment that is related to credit and the amount due to all other factors.

The majority of the unrealized or unrecognized losses on mortgage-backed securities are attributable to changes in interest rates and a re-pricing of risk in the market. Agency mortgage-backed securities and CMOs, agency debentures and agency debt securities are guaranteed by U.S. government sponsored and federal agencies. Municipal bonds and corporate bonds are evaluated by reviewing the credit-worthiness of the issuer and general market conditions. The Company does not intend to sell the securities in an unrealized or unrecognized loss position as of the balance sheet date and it is not more likely than not that the Company will be required to sell the debt securities before the anticipated recovery of its remaining amortized cost of the securities in an unrealized or unrecognized loss position at September 30, 2013.

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

Within the securities portfolio, the highest concentration of credit risk is the non-agency CMO portfolio. As of September 30, 2013, the Company held approximately \$18.6 million in amortized cost of non-agency CMO securities that had been other-than-temporarily impaired as a result of deterioration in the expected credit performance of the underlying loans in the securities. The following table presents a summary of the significant inputs considered for securities that were other-than-temporarily impaired as of September 30, 2013:

| | September 30, 2013 | |
|-----------------------------|--------------------|-----------|
| | Weighted Average | Range |
| Default rate ⁽¹⁾ | 4% | 2% - 5% |
| Loss severity | 48% | 45% - 50% |
| Prepayment rate | 8% | 4% - 10% |

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

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The following table presents a roll forward for the three and nine months ended September 30, 2013 and 2012 of the credit loss component on debt securities held by the Company that had a noncredit loss recognized in other comprehensive income (loss) and had a credit loss recognized in earnings (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------------|------------------------------------|------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Credit loss balance, beginning of period | \$165,074 | \$211,746 | \$186,722 | \$202,945 |
| Additions: | | | | |
| Subsequent credit impairment | 586 | 2,395 | 2,331 | 11,196 |
| Securities sold | — | (12,954) | (23,393) | (12,954) |
| Credit loss balance, end of period ⁽¹⁾ | <u>\$165,660</u> | <u>\$201,187</u> | <u>\$165,660</u> | <u>\$201,187</u> |

⁽¹⁾ The credit loss balance at September 30, 2013 included \$120.8 million of credit losses associated with debt securities that have been factored to zero, but the Company still holds legal title to these securities until maturity or until they are sold.

The following table shows the components of net impairment for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------------|------------------------------------|--------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Other-than-temporary impairment (“OTTI”) | \$ — | \$ (2,052) | \$ (632) | \$ (16,113) |
| Less: noncredit portion of OTTI recognized into (out of) other comprehensive income (loss) (before tax) | (586) | (343) | (1,699) | 4,917 |
| Net impairment | <u>\$ (586)</u> | <u>\$ (2,395)</u> | <u>\$ (2,331)</u> | <u>\$ (11,196)</u> |

Gains on Loans and Securities, Net

The detailed components of the gains on loans and securities, net line item on the consolidated statement of income (loss) for the three and nine months ended September 30, 2013 and 2012 are as follows (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------------|------------------------------------|------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Gains (losses) on loans, net | \$ (554) | \$ 217 | \$ (842) | \$ 379 |
| Gains on securities, net | | | | |
| Gains on available-for-sale securities | 15,699 | 82,049 | 57,779 | 150,067 |
| Losses on available-for-sale securities | — | (2,002) | (8,401) | (4,984) |
| Losses on trading securities, net | — | (3) | (1) | (111) |
| Hedge ineffectiveness | (2,932) | (1,284) | 419 | (6,783) |
| Gains on securities, net | <u>12,767</u> | <u>78,760</u> | <u>49,796</u> | <u>138,189</u> |
| Gains on loans and securities, net | <u>\$12,213</u> | <u>\$78,977</u> | <u>\$48,954</u> | <u>\$138,568</u> |

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

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NOTE 6—LOANS RECEIVABLE, NET

Loans receivable, net at September 30, 2013 and December 31, 2012 are summarized as follows (dollars in thousands):

| | September 30, 2013 | December 31, 2012 |
|-----------------------------|--------------------------|----------------------|
| One- to four-family | \$4,712,967 | \$ 5,442,174 |
| Home equity | 3,619,054 | 4,223,461 |
| Consumer and other | 641,070 | 844,942 |
| Total loans receivable | 8,973,091 | 10,510,577 |
| Unamortized premiums, net | 50,444 | 68,897 |
| Allowance for loan losses | (458,921) | (480,751) |
| Total loans receivable, net | <u>\$8,564,614</u> | <u>\$10,098,723</u> |

At September 30, 2013, we pledged \$7.1 billion and \$0.6 billion of loans as collateral to the FHLB and Federal Reserve Bank, respectively. At December 31, 2012, we pledged \$8.2 billion and \$0.8 billion of loans as collateral to the FHLB and Federal Reserve Bank, respectively. Additionally, the Company's entire loans receivable portfolio was serviced by other companies at September 30, 2013 and December 31, 2012.

The following table represents the breakdown of the total recorded investment in loans receivable and allowance for loan losses by loans that have been collectively evaluated for impairment and those that have been individually evaluated for impairment at September 30, 2013 and December 31, 2012 (dollars in thousands):

| | Recorded Investment | | Allowance for Loan Losses | |
|---|-----------------------|----------------------|---------------------------|----------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| Loans collectively evaluated for impairment | \$7,574,404 | \$ 9,073,326 | \$ 323,582 | \$ 309,377 |
| Loans individually evaluated for impairment (TDRs) | 1,449,131 | 1,506,148 | 135,339 | 171,374 |
| Total loans evaluated for impairment | <u>\$9,023,535</u> | <u>\$10,579,474</u> | <u>\$ 458,921</u> | <u>\$ 480,751</u> |

Credit Quality

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

The home equity loan portfolio is primarily second lien loans on residential real estate properties, which have a higher level of credit risk than first lien mortgage loans. Approximately 15% of the home equity portfolio was in the first lien position as of September 30, 2013. The Company holds both the first and second lien positions in less than 1% of the home equity loan portfolio. The home equity loan portfolio consists of approximately 21% of home equity installment loans and approximately 79% of home equity lines of credit.

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Home equity installment loans are primarily fixed rate and fixed term, fully amortizing loans that do not offer the option of an interest-only payment. The majority of home equity lines of credit convert to amortizing loans at the end of the draw period, which typically ranges from five to ten years. Approximately 9% of this portfolio will require the borrowers to repay the loan in full at the end of the draw period. At September 30, 2013, the majority of the home equity line of credit portfolio had not converted from the interest-only draw period and approximately 80% of this portfolio will not begin amortizing until after 2014. The following table outlines when home equity lines of credit convert to amortizing for the home equity line of credit portfolio as of September 30, 2013:

| <u>Period of Conversion to Amortizing Loan</u> | <u>% of Home Equity Line of Credit Portfolio</u> |
|--|--|
| Already amortizing | 11% |
| Through December 31, 2013 | 1% |
| Year ending December 31, 2014 | 8% |
| Year ending December 31, 2015 | 26% |
| Year ending December 31, 2016 | 41% |
| Year ending December 31, 2017 | 13% |

The following tables show the distribution of the Company's mortgage loan portfolios by credit quality indicator at September 30, 2013 and December 31, 2012 (dollars in thousands):

| <u>Current LTV/CLTV⁽¹⁾</u> | <u>One- to Four-Family</u> | | <u>Home Equity</u> | |
|---|----------------------------|--------------------------|---------------------------|--------------------------|
| | <u>September 30, 2013</u> | <u>December 31, 2012</u> | <u>September 30, 2013</u> | <u>December 31, 2012</u> |
| <=80% | \$1,828,433 | \$1,324,167 | \$1,080,769 | \$ 927,559 |
| 80%-100% | 1,375,035 | 1,404,415 | 861,282 | 776,199 |
| 100%-120% | 853,381 | 1,231,448 | 789,749 | 932,033 |
| >120% | 656,118 | 1,482,144 | 887,254 | 1,587,670 |
| Total mortgage loans receivable | \$4,712,967 | \$5,442,174 | \$3,619,054 | \$4,223,461 |
| Average estimated current LTV/CLTV ⁽²⁾ | 93.8% | 108.1% | 101.7% | 113.8% |
| Average LTV/CLTV at loan origination ⁽³⁾ | 71.4% | 71.2% | 79.6% | 79.4% |

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

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

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

| <u>Documentation Type</u> | <u>One- to Four-Family</u> | | <u>Home Equity</u> | |
|--|----------------------------|--------------------------|---------------------------|--------------------------|
| | <u>September 30, 2013</u> | <u>December 31, 2012</u> | <u>September 30, 2013</u> | <u>December 31, 2012</u> |
| Full documentation | \$1,956,226 | \$2,317,933 | \$1,851,566 | \$2,166,554 |
| Low/no documentation | 2,756,741 | 3,124,241 | 1,767,488 | 2,056,907 |
| Total mortgage loans receivable | \$4,712,967 | \$5,442,174 | \$3,619,054 | \$4,223,461 |

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| Current FICO ⁽¹⁾ | One- to Four-Family | | Home Equity | |
|--|---------------------|--------------------|--------------------|--------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| ≥720 | \$2,370,515 | \$2,819,541 | \$1,896,798 | \$2,238,296 |
| 719 - 700 | 457,204 | 498,057 | 363,215 | 417,926 |
| 699 - 680 | 377,330 | 425,474 | 302,906 | 345,771 |
| 679 - 660 | 296,568 | 347,219 | 245,126 | 279,765 |
| 659 - 620 | 443,438 | 494,021 | 328,278 | 370,282 |
| <620 | 767,912 | 857,862 | 482,731 | 571,421 |
| Total mortgage loans receivable | \$4,712,967 | \$5,442,174 | \$3,619,054 | \$4,223,461 |

(1) FICO scores are updated on a quarterly basis; however, as of September 30, 2013 and December 31, 2012, there were some loans for which the updated FICO scores were not available. The current FICO distribution as of September 30, 2013 included original FICO scores for approximately \$101 million and \$10 million of one- to four-family and home equity loans, respectively. The current FICO distribution as of December 31, 2012 included original FICO scores for approximately \$121 million and \$20 million of one- to four-family and home equity loans, respectively.

| Vintage Year | One- to Four-Family | | Home Equity | |
|--|---------------------|--------------------|--------------------|--------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| 2003 and prior | \$ 153,797 | \$ 190,407 | \$ 166,956 | \$ 218,182 |
| 2004 | 448,991 | 514,283 | 293,875 | 359,737 |
| 2005 | 918,997 | 1,095,047 | 970,099 | 1,131,341 |
| 2006 | 1,865,445 | 2,123,395 | 1,702,268 | 1,962,946 |
| 2007 | 1,323,440 | 1,515,020 | 477,296 | 542,203 |
| 2008 | 2,297 | 4,022 | 8,560 | 9,052 |
| Total mortgage loans receivable | \$4,712,967 | \$5,442,174 | \$3,619,054 | \$4,223,461 |
| Average age of mortgage loans receivable (years) | 7.4 | 6.7 | 7.6 | 6.9 |

| Geographic Location | One- to Four-Family | | Home Equity | |
|--|---------------------|--------------------|--------------------|--------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| California | \$2,234,379 | \$2,568,709 | \$1,136,459 | \$1,333,317 |
| New York | 320,454 | 386,380 | 270,845 | 313,148 |
| Florida | 317,160 | 368,319 | 259,053 | 298,860 |
| Virginia | 212,384 | 235,019 | 164,693 | 192,143 |
| Other states | 1,628,590 | 1,883,747 | 1,788,004 | 2,085,993 |
| Total mortgage loans receivable | \$4,712,967 | \$5,442,174 | \$3,619,054 | \$4,223,461 |

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Delinquent Loans

The following table shows total loans receivable by delinquency category as of September 30, 2013 and December 31, 2012 (dollars in thousands):

| | Current | 30-89 Days Delinquent | 90-179 Days Delinquent | 180+ Days Delinquent | Total |
|---------------------------|---------------------|--------------------------|---------------------------|-------------------------|----------------------|
| September 30, 2013 | | | | | |
| One- to four-family | \$ 4,205,950 | \$ 196,485 | \$ 71,050 | \$ 239,482 | \$ 4,712,967 |
| Home equity | 3,473,294 | 69,494 | 38,464 | 37,802 | 3,619,054 |
| Consumer and other | 626,424 | 12,128 | 2,518 | — | 641,070 |
| Total loans receivable | <u>\$ 8,305,668</u> | <u>\$ 278,107</u> | <u>\$ 112,032</u> | <u>\$ 277,284</u> | <u>\$ 8,973,091</u> |
| December 31, 2012 | | | | | |
| One- to four-family | \$ 4,834,915 | \$ 233,796 | \$ 94,652 | \$ 278,811 | \$ 5,442,174 |
| Home equity | 4,028,936 | 89,347 | 64,239 | 40,939 | 4,223,461 |
| Consumer and other | 819,468 | 19,101 | 6,178 | 195 | 844,942 |
| Total loans receivable | <u>\$ 9,683,319</u> | <u>\$ 342,244</u> | <u>\$ 165,069</u> | <u>\$ 319,945</u> | <u>\$ 10,510,577</u> |

Nonperforming Loans

The Company classifies loans as nonperforming when they are no longer accruing interest. Nonaccrual loans include loans that are 90 days and greater past due, TDRs that are on nonaccrual status for all classes of loans and certain junior liens that have a delinquent senior lien. As of September 30, 2013, the Company had nonaccrual loans of \$547.3 million, \$180.3 million and \$2.5 million for one- to four-family, home equity and consumer and other loans, respectively. As of December 31, 2012, the Company had nonaccrual loans of \$639.1 million, \$247.5 million and \$6.4 million for one- to four-family, home equity and consumer and other loans, respectively.

Allowance for Loan Losses

The following table provides a roll forward by loan portfolio of the allowance for loan losses for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| | Three Months Ended September 30, 2013 | | | |
|--|---------------------------------------|-------------------|-----------------------|-------------------|
| | One- to Four-Family | Home Equity | Consumer and Other | Total |
| Allowance for loan losses, beginning of period | \$ 143,569 | \$ 279,037 | \$28,340 | \$450,946 |
| Provision for loan losses | (23,748) | 59,927 | 1,220 | 37,399 |
| Charge-offs | (6,700) | (29,601) | (5,647) | (41,948) |
| Recoveries | — | 9,715 | 2,809 | 12,524 |
| Charge-offs, net | (6,700) | (19,886) | (2,838) | (29,424) |
| Allowance for loan losses, end of period | <u>\$ 113,121</u> | <u>\$ 319,078</u> | <u>\$26,722</u> | <u>\$458,921</u> |
| | Three Months Ended September 30, 2012 | | | |
| | One- to Four-Family | Home Equity | Consumer and Other | Total |
| Allowance for loan losses, beginning of period | \$ 215,934 | \$ 266,883 | \$ 42,939 | \$ 525,756 |
| Provision for loan losses | 24,702 | 105,022 | 11,295 | 141,019 |
| Charge-offs | (34,236) | (120,337) | (17,074) | (171,647) |
| Recoveries | — | 9,321 | 3,833 | 13,154 |
| Charge-offs, net | (34,236) | (111,016) | (13,241) | (158,493) |
| Allowance for loan losses, end of period | <u>\$ 206,400</u> | <u>\$ 260,889</u> | <u>\$ 40,993</u> | <u>\$ 508,282</u> |

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| | Nine Months Ended September 30, 2013 | | | |
|--|--------------------------------------|-------------|-----------------------|------------|
| | One- to Four-Family | Home Equity | Consumer and Other | Total |
| Allowance for loan losses, beginning of period | \$ 183,937 | \$ 257,333 | \$ 39,481 | \$ 480,751 |
| Provision for loan losses | (48,576) | 168,465 | 6,309 | 126,198 |
| Charge-offs | (36,740) | (132,939) | (28,448) | (198,127) |
| Recoveries | 14,500 | 26,219 | 9,380 | 50,099 |
| Charge-offs, net | (22,240) | (106,720) | (19,068) | (148,028) |
| Allowance for loan losses, end of period | \$ 113,121 | \$ 319,078 | \$ 26,722 | \$ 458,921 |

| | Nine Months Ended September 30, 2012 | | | |
|--|--------------------------------------|-------------|-----------------------|------------|
| | One- to Four-Family | Home Equity | Consumer and Other | Total |
| Allowance for loan losses, beginning of period | \$ 314,187 | \$ 463,288 | \$ 45,341 | \$ 822,816 |
| Provision for loan losses | 40,816 | 213,049 | 26,362 | 280,227 |
| Charge-offs | (157,869) | (445,458) | (40,310) | (643,637) |
| Recoveries | 9,266 | 30,010 | 9,600 | 48,876 |
| Charge-offs, net | (148,603) | (415,448) | (30,710) | (594,761) |
| Allowance for loan losses, end of period | \$ 206,400 | \$ 260,889 | \$ 40,993 | \$ 508,282 |

During the nine months ended September 30, 2013, the allowance for loan losses decreased by \$21.8 million from \$480.7 million at December 31, 2012. During the three and nine months ended September 30, 2013, the Company evaluated and refined its default assumptions related to a subset of the home equity line of credit portfolio that will require borrowers to repay the loan in full at the end of the draw period, commonly referred to as “balloon loans”. These loans were approximately \$250 million of the home equity line of credit portfolio at September 30, 2013. The Company evaluated the significant burden a balloon payment may place on a borrower with a low FICO score and high CLTV ratio, and examined those loans within the balloon portfolio. The Company refined its expectations and estimates around the time period that it might take for these borrowers’ equity positions in their collateral to appreciate in order to allow for possible refinance of the balloon loan at maturity. As a result of this evaluation, the Company increased its default assumptions and extended the period of management’s forecasted loan losses captured within the general allowance to include the total probable loss on this subset of balloon loans. The overall impact of these enhancements drove the majority of provision for loan losses during the three and nine months ended September 30, 2013.

The general allowance for loan losses also included a qualitative component to account for a variety of factors that are not directly considered in the quantitative loss model but are factors the Company believes may impact the level of credit losses. The qualitative component was \$52 million and \$44 million at September 30, 2013 and December 31, 2012, respectively.

During the nine months ended September 30, 2013 and 2012, the Company agreed to settlements with three third party mortgage originators specific to loans sold to the Company by those originators. One-time payments were agreed upon to satisfy in full all pending and future repurchase requests with these specific originators. The Company applied the full amount of the payments of \$12.5 million and \$11.2 million for the nine months ended September 30, 2013 and 2012, respectively, as recoveries to the allowance for loan losses, resulting in a corresponding reduction to net charge-offs as well as provision for loan losses.

During the first quarter of 2012, the Company completed an evaluation of certain programs and practices that were designed in accordance with guidance from the Company’s former regulator, the OTS. The evaluation was initiated in connection with the Company’s transition from the OTS to the OCC, its new primary banking regulator. As a result of the evaluation, loan modification policies and procedures were aligned with the guidance from the OCC. The review resulted in a significant increase in charge-offs during the first quarter of 2012. The

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majority of the losses associated with charge-offs were previously reflected in the specific valuation allowance and qualitative component of the general allowance for loan losses.

The Company utilizes third party loan servicers to obtain bankruptcy data on its borrowers and during the third quarter of 2012, the Company identified an increase in bankruptcies reported by one specific servicer. In researching this increase, it was discovered that the servicer had not been reporting historical bankruptcy data on a timely basis. As a result, the Company implemented an enhanced procedure around all servicer reporting to corroborate bankruptcy reporting with independent third party data. Through this additional process, approximately \$90 million of loans were identified in which servicers failed to report the bankruptcy filing to the Company. As a result, these loans were written down to the estimated current value of the underlying property less estimated selling costs, or approximately \$40 million, during the third quarter of 2012. These newly identified bankruptcy filings resulted in an increase to net charge-offs and provision for loan losses of \$50 million for the three months ended September 30, 2012, with approximately 80% related to prior years.

Impaired Loans—Troubled Debt Restructurings

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

TDRs are accounted for as nonaccrual loans at the time of classification and return to accrual status after six consecutive payments are made. TDRs are classified as nonperforming until six consecutive payments have been made.

The unpaid principal balance in one- to four-family TDRs was \$1.2 billion at both September 30, 2013 and December 31, 2012. For home equity loans, the recorded investment in TDRs represents the unpaid principal balance. As of September 30, 2013 the Company had \$196.0 million recorded investment of TDRs that had been charged-off due to bankruptcy notification, \$106.2 million of which were classified as performing. As of December 31, 2012 the Company had \$216.6 million recorded investment of TDRs that had been charged-off due to bankruptcy notification, \$119.2 million of which were classified as performing.

The following table shows a summary of the Company's recorded investment in TDRs that were on accrual and nonaccrual status, in addition to the recorded investment of TDRs as of September 30, 2013 and December 31, 2012 (dollars in thousands):

| | Accrual TDRs ⁽¹⁾ | Nonaccrual TDRs | | | Recorded Investment in TDRs |
|---------------------------|-----------------------------|------------------------|-----------------------|---------------------|-----------------------------|
| | | Current ⁽²⁾ | 30-89 Days Delinquent | 90+ Days Delinquent | |
| September 30, 2013 | | | | | |
| One- to four-family | \$ 785,110 | \$135,490 | \$101,262 | \$174,445 | \$1,196,307 |
| Home equity | 181,870 | 28,115 | 14,768 | 28,071 | 252,824 |
| Total | <u>\$ 966,980</u> | <u>\$163,605</u> | <u>\$116,030</u> | <u>\$202,516</u> | <u>\$1,449,131</u> |
| December 31, 2012 | | | | | |
| One- to four-family | \$ 785,199 | \$142,373 | \$118,834 | \$182,719 | \$1,229,125 |
| Home equity | 196,199 | 35,750 | 17,634 | 27,440 | 277,023 |
| Total | <u>\$ 981,398</u> | <u>\$178,123</u> | <u>\$136,468</u> | <u>\$210,159</u> | <u>\$1,506,148</u> |

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

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

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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 and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| | Average Recorded Investment | | Interest Income Recognized | |
|---------------------|----------------------------------|--------------------|----------------------------------|----------------|
| | Three Months Ended September 30, | | Three Months Ended September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| One- to four-family | \$1,203,622 | \$1,067,178 | \$ 8,425 | \$6,867 |
| Home equity | 255,899 | 259,608 | 4,857 | 2,778 |
| Total | \$1,459,521 | \$1,326,786 | \$13,282 | \$9,645 |

| | Average Recorded Investment | | Interest Income Recognized | |
|---------------------|---------------------------------|--------------------|---------------------------------|-----------------|
| | Nine Months Ended September 30, | | Nine Months Ended September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| One- to four-family | \$1,211,935 | \$1,031,729 | \$25,092 | \$23,288 |
| Home equity | 266,748 | 311,785 | 15,011 | 8,224 |
| Total | \$1,478,683 | \$1,343,514 | \$40,103 | \$31,512 |

Included in the allowance for loan losses was a specific valuation allowance of \$135.4 million and \$171.4 million that was established for TDRs at September 30, 2013 and December 31, 2012, respectively. The specific allowance for these individually impaired loans represents the forecasted losses over the estimated remaining life of the loan, including the economic concession to the borrower. The following table shows detailed information related to the Company's loans that were modified in a TDR as of September 30, 2013 and December 31, 2012 (dollars in thousands):

| | September 30, 2013 | | | December 31, 2012 | | |
|--|-----------------------------|------------------------------|------------------------|-----------------------------|------------------------------|------------------------|
| | Recorded Investment in TDRs | Specific Valuation Allowance | Net Investment in TDRs | Recorded Investment in TDRs | Specific Valuation Allowance | Net Investment in TDRs |
| With a recorded allowance: | | | | | | |
| One- to four-family | \$ 424,311 | \$ 67,764 | \$ 356,547 | \$ 503,557 | \$ 89,684 | \$ 413,873 |
| Home equity | \$ 149,671 | \$ 67,575 | \$ 82,096 | \$ 185,133 | \$ 81,690 | \$ 103,443 |
| Without a recorded allowance:⁽¹⁾ | | | | | | |
| One- to four-family | \$ 771,996 | \$ — | \$ 771,996 | \$ 725,568 | \$ — | \$ 725,568 |
| Home equity | \$ 103,153 | \$ — | \$ 103,153 | \$ 91,890 | \$ — | \$ 91,890 |
| Total: | | | | | | |
| One- to four-family | \$ 1,196,307 | \$ 67,764 | \$ 1,128,543 | \$ 1,229,125 | \$ 89,684 | \$ 1,139,441 |
| Home equity | \$ 252,824 | \$ 67,575 | \$ 185,249 | \$ 277,023 | \$ 81,690 | \$ 195,333 |

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

Troubled Debt Restructurings—Loan Modifications

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

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The vast majority of the Company's TDR loan modifications include an interest rate reduction in combination with another type of concession. The Company prioritizes the interest rate reduction modifications in combination with the following modification categories: principal forgiven, principal deferred and re-age/extension/capitalization of accrued interest. Each class is mutually exclusive in that if a modification had an interest rate reduction with principal forgiven and an extension, the modification would only 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 and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| Three Months Ended September 30, 2013 | | | | | | | |
|---------------------------------------|-----------------|--------------------|--------------------|---|--|----------|-----------|
| Interest Rate Reduction | | | | | | | |
| | Number of Loans | Principal Forgiven | Principal Deferred | Re-age/ Extension/ Interest Capitalization | Other with Interest Rate Reduction | Other | Total |
| One- to four-family | 94 | \$ 4,345 | \$ 1,453 | \$ 19,917 | \$ 2,749 | \$ 5,244 | \$ 33,708 |
| Home equity | 48 | — | — | 2,304 | 783 | 1,154 | 4,241 |
| Total | 142 | \$ 4,345 | \$ 1,453 | \$ 22,221 | \$ 3,532 | \$ 6,398 | \$ 37,949 |

| Three Months Ended September 30, 2012 | | | | | | | |
|---------------------------------------|-----------------|--------------------|--------------------|---|--|----------|-----------|
| Interest Rate Reduction | | | | | | | |
| | Number of Loans | Principal Forgiven | Principal Deferred | Re-age/ Extension/ Interest Capitalization | Other with Interest Rate Reduction | Other | Total |
| One- to four-family | 148 | \$ 13,448 | \$ 5,706 | \$ 28,677 | \$ 2,579 | \$ 5,142 | \$ 55,552 |
| Home equity | 83 | 276 | 82 | 982 | 4,535 | 2,135 | 8,010 |
| Total | 231 | \$ 13,724 | \$ 5,788 | \$ 29,659 | \$ 7,114 | \$ 7,277 | \$ 63,562 |

| Nine Months Ended September 30, 2013 | | | | | | | |
|--------------------------------------|-----------------|--------------------|--------------------|---|--|-----------|------------|
| Interest Rate Reduction | | | | | | | |
| | Number of Loans | Principal Forgiven | Principal Deferred | Re-age/ Extension/ Interest Capitalization | Other with Interest Rate Reduction | Other | Total |
| One- to four-family | 269 | \$ 16,240 | \$ 4,641 | \$ 61,827 | \$ 4,362 | \$ 13,668 | \$ 100,738 |
| Home equity | 200 | — | — | 5,184 | 7,012 | 5,381 | 17,577 |
| Total | 469 | \$ 16,240 | \$ 4,641 | \$ 67,011 | \$ 11,374 | \$ 19,049 | \$ 118,315 |

| Nine Months Ended September 30, 2012 | | | | | | | |
|--------------------------------------|-----------------|--------------------|--------------------|---|--|-----------|------------|
| Interest Rate Reduction | | | | | | | |
| | Number of Loans | Principal Forgiven | Principal Deferred | Re-age/ Extension/ Interest Capitalization | Other with Interest Rate Reduction | Other | Total |
| One- to four-family | 528 | \$ 41,936 | \$ 32,535 | \$ 119,088 | \$ 7,793 | \$ 16,958 | \$ 218,310 |
| Home equity | 488 | 276 | 82 | 4,667 | 35,005 | 4,056 | 44,086 |
| Total | 1,016 | \$ 42,212 | \$ 32,617 | \$ 123,755 | \$ 42,798 | \$ 21,014 | \$ 262,396 |

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| | Three Months Ended September 30, | | | | | |
|--------------------|----------------------------------|--|---|--------------------|--|---|
| | 2013 | | | 2012 | | |
| | Principal Forgiven | Pre-TDR Weighted Average Interest Rate | Post-TDR Weighted Average Interest Rate | Principal Forgiven | Pre-TDR Weighted Average Interest Rate | Post-TDR Weighted Average Interest Rate |
| One-to four-family | \$ 1,532 | 5.1% | 2.3% | \$ 4,841 | 5.7% | 2.2% |
| Home equity | — | 5.0% | 2.4% | 88 | 4.5% | 1.6% |
| Total | <u>\$ 1,532</u> | | | <u>\$ 4,929</u> | | |

| | Nine Months Ended September 30, | | | | | |
|--------------------|---------------------------------|--|---|--------------------|--|---|
| | 2013 | | | 2012 | | |
| | Principal Forgiven | Pre-TDR Weighted Average Interest Rate | Post-TDR Weighted Average Interest Rate | Principal Forgiven | Pre-TDR Weighted Average Interest Rate | Post-TDR Weighted Average Interest Rate |
| One-to four-family | \$ 5,921 | 5.2% | 2.3% | \$12,818 | 5.9% | 2.4% |
| Home equity | — | 4.5% | 1.9% | 96 | 4.4% | 1.6% |
| Total | <u>\$ 5,921</u> | | | <u>\$12,914</u> | | |

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

| | Three Months Ended September 30, 2013 | | Nine Months Ended September 30, 2013 | |
|----------------------------|--|------------------------|---|------------------------|
| | Number of Loans | Recorded Investment | Number of Loans | Recorded Investment |
| | One- to four-family ⁽¹⁾ | 38 | \$ 14,544 | 111 |
| Home equity ⁽²⁾ | 20 | 580 | 56 | 2,151 |
| Total | <u>58</u> | <u>\$ 15,124</u> | <u>167</u> | <u>\$ 44,740</u> |

| | Three Months Ended September 30, 2012 | | Nine Months Ended September 30, 2012 | |
|----------------------------|--|------------------------|---|------------------------|
| | Number of Loans | Recorded Investment | Number of Loans | Recorded Investment |
| | One- to four-family ⁽¹⁾ | 62 | \$ 22,741 | 208 |
| Home equity ⁽²⁾ | 79 | 3,165 | 305 | 14,968 |
| Total | <u>141</u> | <u>\$ 25,906</u> | <u>513</u> | <u>\$ 95,194</u> |

(1) As of the three and nine months ended September 30, 2013, respectively, \$4.4 million and \$12.4 million of the recorded investment in one- to four-family loans that had a payment default in the trailing 12 months were classified as current, compared to \$6.4 million and \$20.6 million as of the three and nine months ended September 30, 2012, respectively.

(2) As of the three and nine months ended September 30, 2013, respectively, less than \$0.1 million and \$0.6 million of the recorded investment in home equity loans that had a payment default in the trailing 12 months were classified as current, compared to \$2.6 million and \$15.2 million as of the three and nine months ended September 30, 2012, respectively.

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The delinquency status is the primary measure the Company uses to evaluate the performance of TDR loan modifications. The following table shows the TDR loan modifications by delinquency category as of September 30, 2013 and December 31, 2012 (dollars in thousands):

| | <u>Modifications Current</u> | <u>Modifications 30-89 Days Delinquent</u> | <u>Modifications 90-179 Days Delinquent</u> | <u>Modifications 180+ Days Delinquent</u> | <u>Recorded Investment in Modifications</u> |
|---------------------------|----------------------------------|--|---|---|---|
| September 30, 2013 | | | | | |
| One- to four-family | \$ 833,917 | \$ 92,743 | \$ 40,230 | \$ 88,296 | \$1,055,186 |
| Home equity | 172,876 | 11,264 | 5,923 | 7,826 | 197,889 |
| Total | <u>\$1,006,793</u> | <u>\$ 104,007</u> | <u>\$ 46,153</u> | <u>\$ 96,122</u> | <u>\$1,253,075</u> |
| December 31, 2012 | | | | | |
| One- to four-family | \$ 838,020 | \$ 105,142 | \$ 43,905 | \$ 79,102 | \$1,066,169 |
| Home equity | 195,021 | 15,107 | 6,173 | 7,118 | 223,419 |
| Total | <u>\$1,033,041</u> | <u>\$ 120,249</u> | <u>\$ 50,078</u> | <u>\$ 86,220</u> | <u>\$1,289,588</u> |

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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, forward-starting swaps and purchased options, including caps and floors, are used primarily to reduce the variability of future cash flows associated with existing variable-rate assets and liabilities and forecasted issuances of liabilities. Fair value hedges, which include interest rate swaps and swaptions, are used to offset exposure to changes in value of certain fixed-rate assets and liabilities. Each derivative is recorded on the consolidated balance sheet at fair value as a freestanding asset or liability. The following table summarizes the fair value amounts of derivatives designated as hedging instruments reported in the consolidated balance sheet at September 30, 2013 and December 31, 2012 (dollars in thousands):

| | Notional | Fair Value | | Net ⁽³⁾ |
|--|-------------|----------------------|--------------------------|--------------------|
| | | Asset ⁽¹⁾ | Liability ⁽²⁾ | |
| September 30, 2013 | | | | |
| Interest rate contracts: | | | | |
| Cash flow hedges: | | | | |
| Pay-fixed rate swaps | \$2,480,000 | \$12,147 | \$(195,418) | \$(183,271) |
| Purchased options | 825,000 | 7,972 | — | 7,972 |
| Total cash flow hedges | 3,305,000 | 20,119 | (195,418) | (175,299) |
| Fair value hedges: | | | | |
| Pay-fixed rate swaps | 1,442,100 | 59,836 | (10,572) | 49,264 |
| Purchased forward-starting swaps | 19,250 | — | (595) | (595) |
| Total fair value hedges | 1,461,350 | 59,836 | (11,167) | 48,669 |
| Total derivatives designated as hedging instruments ⁽⁴⁾ | \$4,766,350 | \$79,955 | \$(206,585) | \$(126,630) |
| December 31, 2012 | | | | |
| Interest rate contracts: | | | | |
| Cash flow hedges: | | | | |
| Pay-fixed rate swaps | \$2,205,000 | \$ — | \$(310,079) | \$(310,079) |
| Purchased options | 2,325,000 | 13,391 | — | 13,391 |
| Total cash flow hedges | 4,530,000 | 13,391 | (310,079) | (296,688) |
| Fair value hedges: | | | | |
| Pay-fixed rate swaps | 514,180 | 1,343 | (18,385) | (17,042) |
| Total derivatives designated as hedging instruments ⁽⁴⁾ | \$5,044,180 | \$14,734 | \$(328,464) | \$(313,730) |

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

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

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

(4) All derivatives were designated as hedging instruments as of September 30, 2013 and December 31, 2012.

Cash Flow Hedges

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

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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 (loss). 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. As of September 30, 2013, the Company believes the forecasted issuance of all debt in cash flow hedge relationships is probable. However, unexpected changes in market conditions in future periods could impact the ability to issue this debt. The Company believes the forecasted issuance of debt in the form of repurchase agreements is most susceptible to an unexpected change in market conditions.

The following table summarizes the effect of interest rate contracts designated and qualifying as hedging instruments in cash flow hedges on accumulated other comprehensive loss and on the consolidated statement of income (loss) for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Gains (losses) on derivatives recognized in OCI (effective portion), net of tax | \$(11,894) | \$(21,905) | \$ 56,575 | \$(73,602) |
| Losses reclassified from AOCI into earnings (effective portion), net of tax | \$(21,214) | \$(20,471) | \$(64,357) | \$(60,329) |
| Cash flow hedge ineffectiveness gains (losses) ⁽¹⁾ | \$ (74) | \$ 111 | \$ 867 | \$ (862) |

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

During the upcoming twelve months, the Company expects to include a pre-tax amount of approximately \$139.9 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 9 years.

The following table shows the balance in accumulated other comprehensive loss attributable to active and discontinued cash flow hedges at September 30, 2013 and December 31, 2012 (dollars in thousands):

| | September 30, 2013 | December 31, 2012 |
|---|-----------------------|----------------------|
| Accumulated other comprehensive loss balance (net of tax) related to: | | |
| Discontinued cash flow hedges | \$ (212,351) | \$ (247,983) |
| Active cash flow hedges | (119,058) | (204,358) |
| Total cash flow hedges | <u>\$ (331,409)</u> | <u>\$ (452,341)</u> |

The following table shows the balance in accumulated other comprehensive loss attributable to cash flow hedges by type of hedged item at September 30, 2013 and December 31, 2012 (dollars in thousands):

| | September 30, 2013 | December 31, 2012 |
|---|-----------------------|----------------------|
| Repurchase agreements | \$ (424,217) | \$ (579,763) |
| FHLB advances | (108,941) | (146,253) |
| Home equity lines of credit | 793 | 7,854 |
| Other | — | 116 |
| Total balance of cash flow hedges, before tax | (532,365) | (718,046) |
| Tax benefit | 200,956 | 265,705 |
| Total balance of cash flow hedges, net of tax | <u>\$ (331,409)</u> | <u>\$ (452,341)</u> |

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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 derivatives and the underlying assets or liabilities are recognized in the gains on loans and securities, net line item in the consolidated statement of income (loss). 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 (loss).

Hedge accounting is discontinued for fair value hedges if a derivative instrument is sold, terminated or otherwise de-designated. If fair value hedge accounting is discontinued, the previously hedged item is no longer adjusted for changes in fair value through the consolidated statement of income (loss) 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 (loss).

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 (loss) for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

| | Three Months Ended September 30, | | | | | |
|---|----------------------------------|-------------------|--------------------------------------|--------------------|-------------------|--------------------------------------|
| | 2013 | | | 2012 | | |
| | Hedging Instrument | Hedged Item | Hedge Ineffectiveness ⁽¹⁾ | Hedging Instrument | Hedged Item | Hedge Ineffectiveness ⁽¹⁾ |
| Agency debentures | \$ 3,204 | \$(4,558) | \$ (1,354) | \$ (1,475) | \$ 1,481 | \$ 6 |
| Agency mortgage-backed securities | (7,302) | 5,798 | (1,504) | (2,260) | 2,141 | (119) |
| FHLB advances | — | — | — | 5,736 | (7,018) | (1,282) |
| Total gains (losses) included in earnings | <u>\$ (4,098)</u> | <u>\$ 1,240</u> | <u>\$ (2,858)</u> | <u>\$ 2,001</u> | <u>\$ (3,396)</u> | <u>\$ (1,395)</u> |
| | Nine Months Ended September 30, | | | | | |
| | 2013 | | | 2012 | | |
| | Hedging Instrument | Hedged Item | Hedge Ineffectiveness ⁽¹⁾ | Hedging Instrument | Hedged Item | Hedge Ineffectiveness ⁽¹⁾ |
| Agency debentures | \$ 48,505 | \$(47,994) | \$ 511 | \$(27,875) | \$ 26,319 | \$ (1,556) |
| Agency mortgage-backed securities | 20,548 | (21,507) | (959) | (7,303) | 6,745 | (558) |
| FHLB advances | — | — | — | 14,939 | (18,746) | (3,807) |
| Total gains (losses) included in earnings | <u>\$ 69,053</u> | <u>\$(69,501)</u> | <u>\$ (448)</u> | <u>\$(20,239)</u> | <u>\$ 14,318</u> | <u>\$ (5,921)</u> |

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

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NOTE 8—GOODWILL

The activity in the carrying value of the Company's goodwill, which is all assigned to the trading and investing segment, is outlined in the following table for the periods presented (dollars in thousands):

| | Trading & Investing Goodwill |
|-------------------------------|---------------------------------|
| Balance at December 31, 2011 | \$ 1,934,232 |
| Activity | — |
| Balance at December 31, 2012 | 1,934,232 |
| Impairment of goodwill | (142,423) |
| Balance at September 30, 2013 | <u>\$ 1,791,809</u> |

At the end of June 2013, the Company decided to exit its market making business, and as a result evaluated the total goodwill allocated to the market making reporting unit for impairment. As a result of the evaluation, it was determined that the entire carrying amount of goodwill allocated to the market making reporting unit was impaired, and the Company recognized \$142.4 million impairment of goodwill during the second quarter of 2013.

No goodwill was assigned to reporting units within the balance sheet management segment as of September 30, 2013 and December 31, 2012. As of September 30, 2013, the Company's accumulated impairment losses related to goodwill were \$142.4 million and \$101.2 million in the trading and investing and balance sheet management segments, respectively. As of December 31, 2012, the Company's accumulated impairment losses related to goodwill were \$101.2 million in the balance sheet management segment. There were no accumulated impairment losses related to the trading and investing segment at December 31, 2012. The Company will continue to evaluate the goodwill for impairment on at least an annual basis or when events or changes indicate the carrying value of an asset may not be recoverable.

NOTE 9—DEPOSITS

Deposits are summarized as follows (dollars in thousands):

| | Amount | | Weighted-Average Rate | |
|---|-----------------------|----------------------|-----------------------|----------------------|
| | September 30, 2013 | December 31, 2012 | September 30, 2013 | December 31, 2012 |
| Sweep deposits ⁽¹⁾ | \$19,453,183 | \$21,253,611 | 0.06% | 0.05% |
| Complete savings deposits | 4,407,250 | 4,981,615 | 0.01% | 0.01% |
| Checking deposits | 1,022,788 | 1,055,422 | 0.03% | 0.03% |
| Other money market and savings deposits | 918,631 | 995,188 | 0.01% | 0.01% |
| Time deposits ⁽²⁾ | 67,945 | 106,716 | 0.70% | 1.75% |
| Total deposits ⁽³⁾ | <u>\$25,869,797</u> | <u>\$28,392,552</u> | 0.05% | 0.05% |

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

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

⁽³⁾ As of September 30, 2013 and December 31, 2012, the Company had \$120.5 million and \$113.1 million in non-interest bearing deposits, respectively.

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NOTE 10—SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND FHLB ADVANCES AND OTHER BORROWINGS

Securities sold under agreements to repurchase, FHLB advances and other borrowings at September 30, 2013 and December 31, 2012 are shown in the following table (dollars in thousands):

| | Repurchase Agreements ⁽¹⁾ | FHLB Advances and Other Borrowings | | Total | Weighted Average Interest Rate |
|--|--------------------------------------|------------------------------------|------------------|--------------------|--------------------------------|
| | | FHLB Advances | Other | | |
| Due within one year | \$3,499,665 | \$ 170,000 | \$ 11,234 | \$3,680,899 | 0.35 % |
| Due between one and two years | 200,000 | 100,000 | — | 300,000 | 1.22 % |
| Due between two and three years | 250,000 | 250,000 | — | 500,000 | 0.46 % |
| Due between three and four years | 500,000 | 400,000 | — | 900,000 | 1.26 % |
| Thereafter | — | — | 427,806 | 427,806 | 2.93 % |
| Subtotal | 4,449,665 | 920,000 | 439,040 | 5,808,705 | 0.74 % |
| Fair value hedge adjustments | — | 31,034 | — | 31,034 | |
| Deferred costs | — | (105,063) | — | (105,063) | |
| Total other borrowings at September 30, 2013 | <u>\$4,449,665</u> | <u>\$ 845,971</u> | <u>\$439,040</u> | <u>\$5,734,676</u> | 0.74 % |
| Total other borrowings at December 31, 2012 | <u>\$4,454,661</u> | <u>\$ 831,749</u> | <u>\$429,167</u> | <u>\$5,715,577</u> | 0.83 % |

(1) The maximum amount at any month end for repurchase agreements was \$4.6 billion for the nine months ended September 30, 2013 and \$5.0 billion for the year ended December 31, 2012.

NOTE 11—CORPORATE DEBT

Corporate debt at September 30, 2013 and December 31, 2012 is outlined in the following table (dollars in thousands):

| | Face Value | Discount | Net |
|-------------------------------------|--------------------|--------------------|---------------------|
| September 30, 2013 | | | |
| Interest-bearing notes: | | | |
| 6 3/4% Notes, due 2016 | \$ 435,000 | \$ (4,479) | \$ 430,521 |
| 6% Notes, due 2017 | 505,000 | (3,893) | 501,107 |
| 6 3/8% Notes, due 2019 | 800,000 | (6,535) | 793,465 |
| Total interest-bearing notes | 1,740,000 | (14,907) | 1,725,093 |
| Non-interest-bearing debt: | | | |
| 0% Convertible debentures, due 2019 | 42,656 | — | 42,656 |
| Total corporate debt | <u>\$1,782,656</u> | <u>\$ (14,907)</u> | <u>\$ 1,767,749</u> |
| December 31, 2012 | | | |
| Interest-bearing notes: | | | |
| 6 3/4% Notes, due 2016 | \$ 435,000 | \$ (5,738) | \$ 429,262 |
| 6% Notes, due 2017 | 505,000 | (4,601) | 500,399 |
| 6 3/8% Notes, due 2019 | 800,000 | (7,336) | 792,664 |
| Total interest-bearing notes | 1,740,000 | (17,675) | 1,722,325 |
| Non-interest-bearing debt: | | | |
| 0% Convertible debentures, due 2019 | 42,657 | — | 42,657 |
| Total corporate debt | <u>\$1,782,657</u> | <u>\$ (17,675)</u> | <u>\$ 1,764,982</u> |

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NOTE 12—SHAREHOLDERS' EQUITY

The activity in shareholders' equity during the nine months ended September 30, 2013 is summarized in the following table (dollars in thousands):

| | Common Stock / Additional Paid-In Capital | Accumulated Deficit / Other Comprehensive Loss | Total |
|---|--|---|--------------------|
| Beginning balance, December 31, 2012 | \$ 7,322,118 | \$(2,417,648) | \$4,904,470 |
| Net income | — | 28,149 | 28,149 |
| Net change from available-for-sale securities | — | (231,764) | (231,764) |
| Net change from cash flow hedging instruments | — | 120,932 | 120,932 |
| Other ⁽¹⁾ | 7,645 | 142 | 7,787 |
| Ending balance, September 30, 2013 | <u>\$ 7,329,763</u> | <u>\$(2,500,189)</u> | <u>\$4,829,574</u> |

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

Accumulated Other Comprehensive Loss

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

| | Available- for-sale Securities | Cash Flow Hedging Instruments | Foreign Currency Translation | Total |
|--|--------------------------------------|-------------------------------------|------------------------------------|--------------------|
| Beginning balance, June 30, 2013 | \$(103,939) | \$(340,729) | \$ 5,001 | \$(439,667) |
| Other comprehensive income (loss) before reclassifications | 18,824 | (11,894) | 582 | 7,512 |
| Amounts reclassified from accumulated other comprehensive loss | (9,677) | 21,214 | — | 11,537 |
| Net change | 9,147 | 9,320 | 582 | 19,049 |
| Ending balance, September 30, 2013 | <u>\$ (94,792)</u> | <u>\$(331,409)</u> | <u>\$ 5,583</u> | <u>\$(420,618)</u> |

| | Available- for-sale Securities | Cash Flow Hedging Instruments | Foreign Currency Translation | Total |
|--|--------------------------------------|-------------------------------------|------------------------------------|--------------------|
| Beginning balance, June 30, 2012 | \$126,554 | \$(469,792) | \$ 2,539 | \$(340,699) |
| Other comprehensive income (loss) before reclassifications | 87,434 | (21,905) | 1,645 | 67,174 |
| Amounts reclassified from accumulated other comprehensive loss | (50,349) | 20,471 | — | (29,878) |
| Net change | 37,085 | (1,434) | 1,645 | 37,296 |
| Ending balance, September 30, 2012 | <u>\$163,639</u> | <u>\$(471,226)</u> | <u>\$ 4,184</u> | <u>\$(303,403)</u> |

| | Available- for-sale Securities | Cash Flow Hedging Instruments | Foreign Currency Translation | Total |
|--|--------------------------------------|-------------------------------------|------------------------------------|--------------------|
| Beginning balance, December 31, 2012 | \$ 136,972 | \$(452,341) | \$ 5,441 | \$(309,928) |
| Other comprehensive income (loss) before reclassifications | (201,104) | 56,575 | 142 | (144,387) |
| Amounts reclassified from accumulated other comprehensive loss | (30,660) | 64,357 | — | 33,697 |
| Net change | (231,764) | 120,932 | 142 | (110,690) |
| Ending balance, September 30, 2013 | <u>\$ (94,792)</u> | <u>\$(331,409)</u> | <u>\$ 5,583</u> | <u>\$(420,618)</u> |

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| | Available- for-sale Securities | Cash Flow Hedging Instruments | Foreign Currency Translation | Total |
|--|--------------------------------------|-------------------------------------|------------------------------------|--------------------|
| Beginning balance, December 31, 2011 | \$ 68,330 | \$(457,953) | \$ 2,994 | \$(386,629) |
| Other comprehensive income (loss) before reclassifications | 186,257 | (73,602) | 1,190 | 113,845 |
| Amounts reclassified from accumulated other comprehensive loss | (90,948) | 60,329 | — | (30,619) |
| Net change | 95,309 | (13,273) | 1,190 | 83,226 |
| Ending balance, September 30, 2012 | <u>\$163,639</u> | <u>\$(471,226)</u> | <u>\$ 4,184</u> | <u>\$(303,403)</u> |

The following table presents the income statement line items impacted by reclassifications out of accumulated other comprehensive loss during the three and nine months ended September 30, 2013 (dollars in thousands):

| Accumulated Other Comprehensive Loss Components | Amount Reclassified from Accumulated Other Comprehensive Loss | | Affected Line Items in the Income Statement |
|--|--|---|--|
| | Three Months Ended September 30, 2013 | Nine Months Ended September 30, 2013 | |
| Available-for-sale securities: | | | |
| | \$ 15,679 | \$ 49,298 | Gains on loans and securities, net |
| | (6,002) | (18,638) | Tax expense (benefit) |
| | <u>\$ 9,677</u> | <u>\$ 30,660</u> | Reclassification into earnings, net |
| Cash flow hedging instruments: | | | |
| | \$ 2,353 | \$ 7,058 | Operating interest income |
| | (37,413) | (109,360) | Operating interest expense |
| | (35,060) | (102,302) | Reclassification into earnings, before tax |
| | 13,846 | 37,945 | Tax expense (benefit) |
| | <u>\$ (21,214)</u> | <u>\$ (64,357)</u> | Reclassification into earnings, net |

NOTE 13—EARNINGS (LOSS) PER SHARE

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------------|------------------------------------|----------------|
| | 2013 | 2012 | 2013 | 2012 |
| Basic: | | | | |
| Net income (loss) | \$ 47,428 | \$(28,625) | \$ 28,149 | \$ 73,476 |
| Basic weighted-average shares outstanding | 287,111 | 285,850 | 286,882 | 285,658 |
| Basic earnings (loss) per share | <u>\$ 0.17</u> | <u>\$ (0.10)</u> | <u>\$ 0.10</u> | <u>\$ 0.26</u> |
| Diluted: | | | | |
| Net income (loss) | \$ 47,428 | \$(28,625) | \$ 28,149 | \$ 73,476 |
| Basic weighted-average shares outstanding | 287,111 | 285,850 | 286,882 | 285,658 |
| Effect of dilutive securities: | | | | |
| Weighted-average convertible debentures | 4,125 | — | 4,125 | 4,154 |
| Weighted-average options and restricted stock issued to employees | 1,394 | — | 1,242 | 583 |
| Diluted weighted-average shares outstanding | <u>292,630</u> | <u>285,850</u> | <u>292,249</u> | <u>290,395</u> |
| Diluted earnings (loss) per share | <u>\$ 0.16</u> | <u>\$ (0.10)</u> | <u>\$ 0.10</u> | <u>\$ 0.25</u> |

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The Company excluded the following shares from the calculations of diluted earnings (loss) per share as the effect would have been anti-dilutive (shares in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------|------------------------------------|------|
| | 2013 | 2012 | 2013 | 2012 |
| Weighted-average shares excluded as a result of the Company's net loss: | | | | |
| Convertible debentures | N/A | 4.1 | N/A | N/A |
| Stock options and restricted stock awards and units | N/A | 0.4 | N/A | N/A |
| Other stock options and restricted stock awards and units | 1.2 | 2.9 | 1.8 | 2.6 |
| Total | 1.2 | 7.4 | 1.8 | 2.6 |

NOTE 14—REGULATORY REQUIREMENTS

Registered Broker-Dealers

The Company's largest U.S. broker-dealer subsidiaries are subject to the Uniform Net Capital Rule (the "Rule") under the Securities Exchange Act of 1934 administered by the SEC and FINRA, which requires the maintenance of minimum net capital. The minimum net capital requirements can be met under either the Aggregate Indebtedness method or the Alternative method. Under the Aggregate Indebtedness method, a broker-dealer is required to maintain minimum net capital of the greater of 6 2/3% of its aggregate indebtedness, as defined, or a minimum dollar amount. Under the Alternative method, a broker-dealer is required to maintain net capital equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions. The method used depends on the individual U.S. broker-dealer subsidiary. The Company's other broker-dealers, including its international broker-dealer subsidiaries located in Europe and Asia, are subject to capital requirements determined by their respective regulators.

As of September 30, 2013 and December 31, 2012, all of the Company's broker-dealer subsidiaries met minimum net capital requirements. Total required net capital was \$140.5 million and \$129.8 million at September 30, 2013 and December 31, 2012, respectively. In addition, the Company's broker-dealer subsidiaries had excess net capital of \$828.6 million and \$655.1 million at September 30, 2013 and December 31, 2012, respectively. The tables below summarize the minimum excess capital requirements for the Company's broker-dealer subsidiaries at September 30, 2013 and December 31, 2012 (dollars in thousands):

| | Required Net Capital | Net Capital | Excess Net Capital |
|---|----------------------------|-------------------|-----------------------|
| September 30, 2013: | | | |
| E*TRADE Clearing LLC ⁽¹⁾ | \$ 137,061 | \$ 703,752 | \$ 566,691 |
| E*TRADE Securities LLC ⁽¹⁾ | 250 | 215,109 | 214,859 |
| G1 Execution Services, LLC ⁽²⁾ | 1,000 | 21,140 | 20,140 |
| Other broker-dealers | 2,220 | 29,088 | 26,868 |
| Total | <u>\$ 140,531</u> | <u>\$ 969,089</u> | <u>\$ 828,558</u> |
| December 31, 2012: | | | |
| E*TRADE Clearing LLC ⁽¹⁾ | \$ 123,656 | \$ 658,968 | \$ 535,312 |
| E*TRADE Securities LLC ⁽¹⁾ | 250 | 79,318 | 79,068 |
| G1 Execution Services, LLC ⁽²⁾ | 1,283 | 10,598 | 9,315 |
| Other broker-dealers | 4,639 | 36,070 | 31,431 |
| Total | <u>\$ 129,828</u> | <u>\$ 784,954</u> | <u>\$ 655,126</u> |

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

(2) Elected to use the Aggregate Indebtedness method to compute net capital. G1 Execution Services, LLC is the Company's market maker and is held-for-sale as of September 30, 2013.

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Banking

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

Quantitative measures established by regulation to ensure capital adequacy require E*TRADE Bank to meet minimum total capital, Tier 1 capital and Tier 1 leverage ratios. As shown in the table below, at both September 30, 2013 and December 31, 2012, E*TRADE Bank was categorized as "well capitalized" under the regulatory framework for prompt corrective action. However, events beyond management's control, such as a continued deterioration in residential real estate and credit markets, could adversely affect future earnings and E*TRADE Bank's ability to meet its future capital requirements. E*TRADE Bank's actual and required capital amounts and ratios at September 30, 2013 and December 31, 2012 are presented in the table below (dollars in thousands):

| | Actual | | Minimum Required to be Well Capitalized Under Prompt Corrective Action Provisions | | Excess Capital |
|----------------------------|-------------|--------|---|---------|----------------|
| | Amount | Ratio | Amount | Ratio | |
| September 30, 2013: | | | | | |
| Total capital | \$4,242,628 | 23.47% | >\$1,807,504 | >10.00% | \$2,435,124 |
| Tier 1 capital | \$4,013,123 | 22.20% | >\$1,084,502 | >6.00% | \$2,928,621 |
| Tier 1 leverage | \$4,013,123 | 9.48% | >\$2,116,802 | >5.00% | \$1,896,321 |
| December 31, 2012: | | | | | |
| Total capital | \$4,009,540 | 20.61% | >\$1,945,669 | >10.00% | \$2,063,871 |
| Tier 1 capital | \$3,762,242 | 19.34% | >\$1,167,401 | >6.00% | \$2,594,841 |
| Tier 1 leverage | \$3,762,242 | 8.68% | >\$2,167,136 | >5.00% | \$1,595,106 |

NOTE 15—COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS

Legal Matters

Litigation Matters

On October 27, 2000, Ajaxo, Inc. ("Ajaxo") filed a complaint in the Superior Court for the State of California, County of Santa Clara. Ajaxo sought damages and certain non-monetary relief for the Company's alleged breach of a non-disclosure agreement with Ajaxo pertaining to certain wireless technology that Ajaxo offered the Company as well as damages and other relief against the Company for their alleged misappropriation of Ajaxo's trade secrets. Following a jury trial, a judgment was entered in 2003 in favor of Ajaxo against the Company for \$1.3 million for breach of the Ajaxo non-disclosure agreement. Although the jury found in favor of Ajaxo on its claim against the Company for misappropriation of trade secrets, the trial court subsequently denied Ajaxo's requests for additional damages and relief. On December 21, 2005, the California Court of Appeal affirmed the above-described award against the Company for breach of the nondisclosure agreement but remanded the case to the trial court for the limited purpose of determining what, if any, additional damages Ajaxo may be entitled to as a result of the jury's previous finding in favor of Ajaxo on its claim against the

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Company for misappropriation of trade secrets. Although the Company paid Ajaxo the full amount due on the above-described judgment, the case was remanded back to the trial court, and on May 30, 2008, a jury returned a verdict in favor of the Company denying all claims raised and demands for damages against the Company. Following the trial court's filing of entry of judgment in favor of the Company on September 5, 2008, Ajaxo filed post-trial motions for vacating this entry of judgment and requesting a new trial. By order dated November 4, 2008, the trial court denied these motions. On December 2, 2008, Ajaxo filed a notice of appeal with the Court of Appeal of the State of California for the Sixth District. Oral argument on the appeal was heard on July 15, 2010. On August 30, 2010, the Court of Appeal affirmed the trial court's verdict in part and reversed the verdict in part, remanding the case. The Company petitioned the Supreme Court of California for review of the Court of Appeal decision. On December 16, 2010, the California Supreme Court denied the Company's petition for review and remanded for further proceedings to the trial court. On September 20, 2011, the trial court granted limited discovery at a conference on November 4, 2011. The testimonial phase of the third trial in this matter commenced on February 21 and 22, 2012 and concluded on June 12, 2012. The parties await decision on whether there will be a second phase of this bench trial. The Company will continue to defend itself vigorously.

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reached a confidential settlement at mediation on September 12, 2013 pursuant to which plaintiffs were paid a non-material sum as consideration for mutual releases. Payment of the settlement amount was completed on October 15, 2013, and the parties submitted a stipulation of voluntary dismissal on October 16, 2013. The stipulation of voluntary dismissal was so-ordered by the Court on October 22, 2013, and the action is now closed.

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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 LLC 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

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September 13, 2013. The Company's demurrer and motion to strike the complaint are to be set for hearing December 20, 2013. The Company will continue to 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 reasonably estimate a range of possible losses on its remaining outstanding legal proceedings; however, the Company believes any losses would not be reasonably likely to have a material adverse effect on the consolidated financial condition or results of operations of the Company.

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

Regulatory Matters

The securities and banking industries are subject to extensive regulation under federal, state and applicable international laws. From time to time, the Company has been threatened with or named as a defendant in lawsuits, arbitrations and administrative claims involving securities, banking and other matters. The Company is also subject to periodic regulatory audits and inspections. Compliance and trading problems that are reported to regulators, such as the SEC, FINRA or OCC by dissatisfied customers or others are investigated by such regulators, and may, if pursued, result in formal claims being filed against the Company by customers or disciplinary action being taken against the Company or its employees by regulators. Any such claims or disciplinary actions that are decided against the Company could have a material impact on the financial results of the Company or any of its subsidiaries.

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

During 2012, the Company completed a review of order handling practices and pricing for order flow between E*TRADE Securities LLC and G1 Execution Services, LLC. The Company has 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 and may initiate investigations into the Company's historical practices which could subject it to monetary penalties and cease-and-desist orders, which could also prompt claims by customers of E*TRADE Securities LLC. Any of these actions could materially and adversely affect the Company's broker-dealer businesses. On July 11, 2013, FINRA notified E*TRADE Securities LLC and G1 Execution Services, LLC that it is conducting an examination of both firms' routing practices.

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.

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Estimated Liabilities

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

Commitments

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

Other Investments

The Company has investments in low-income housing tax credit partnerships and other limited partnerships. The Company had \$4.4 million in commitments to fund low-income housing tax credit partnerships and other limited partnerships as of September 30, 2013.

Unused Lines of Credit and Certificates of Deposit

At September 30, 2013, the Company had approximately \$42.6 million of certificates of deposit scheduled to mature in less than one year and \$0.4 billion of unfunded commitments to extend credit.

Guarantees

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

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

During the 30-year period prior to the redemption of the trust preferred securities, ETBH guarantees the accrued and unpaid distributions on these securities, as well as the redemption price of the securities and certain costs that may be incurred in liquidating, terminating or dissolving the trusts (all of which would otherwise be payable by the trusts). At September 30, 2013, management estimated that the maximum potential liability under this arrangement, including the current carrying value of the trusts, was equal to approximately \$436.5 million or the total face value of these securities plus dividends, which may be unpaid at the termination of the trust arrangement.

NOTE 16—SEGMENT INFORMATION

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

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 thousands):

| | Three Months Ended September 30, 2013 | | | |
|--|---------------------------------------|-----------------------------|---------------------|------------------|
| | Trading and Investing | Balance Sheet Management | Corporate/ Other | Total |
| Net operating interest income | \$ 133,378 | \$ 107,469 | \$ — | \$240,847 |
| Total non-interest income | 162,735 | 13,220 | — | 175,955 |
| Total net revenue | 296,113 | 120,689 | — | 416,802 |
| Provision for loan losses | — | 37,399 | — | 37,399 |
| Total operating expense | 170,344 | 43,489 | 56,911 | 270,744 |
| Income (loss) before other income (expense) and income taxes | 125,769 | 39,801 | (56,911) | 108,659 |
| Total other income (expense) | — | — | (28,729) | (28,729) |
| Income (loss) before income taxes | \$ 125,769 | \$ 39,801 | \$ (85,640) | 79,930 |
| Income tax expense | | | | 32,502 |
| Net income | | | | <u>\$ 47,428</u> |

| | Three Months Ended September 30, 2012 | | | |
|--|---------------------------------------|-----------------------------|---------------------|--------------------|
| | Trading and Investing | Balance Sheet Management | Corporate/ Other | Total |
| Net operating interest income | \$ 156,805 | \$ 104,072 | \$ — | \$260,877 |
| Total non-interest income | 150,662 | 78,502 | (6) | 229,158 |
| Total net revenue | 307,467 | 182,574 | (6) | 490,035 |
| Provision for loan losses | — | 141,019 | — | 141,019 |
| Total operating expense | 180,463 | 53,204 | 55,366 | 289,033 |
| Income (loss) before other income (expense) and income taxes | 127,004 | (11,649) | (55,372) | 59,983 |
| Total other income (expense) | — | — | (96,286) | (96,286) |
| Income (loss) before income taxes | \$ 127,004 | \$ (11,649) | \$(151,658) | (36,303) |
| Income tax benefit | | | | (7,678) |
| Net loss | | | | <u>\$ (28,625)</u> |

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| | Nine Months Ended September 30, 2013 | | | |
|--|--------------------------------------|-----------------------------|---------------------|------------------|
| | Trading and Investing | Balance Sheet Management | Corporate/ Other | Total |
| Net operating interest income | \$ 400,729 | \$ 323,988 | \$ — | \$ 724,717 |
| Total non-interest income | 500,656 | 51,226 | (1) | 551,881 |
| Total net revenue | 901,385 | 375,214 | (1) | 1,276,598 |
| Provision for loan losses | — | 126,198 | — | 126,198 |
| Total operating expense | 687,361 | 134,990 | 157,855 | 980,206 |
| Income (loss) before other income (expense) and income taxes | 214,024 | 114,026 | (157,856) | 170,194 |
| Total other income (expense) | — | — | (80,678) | (80,678) |
| Income (loss) before income taxes | \$ 214,024 | \$ 114,026 | \$(238,534) | 89,516 |
| Income tax expense | | | | 61,367 |
| Net income | | | | <u>\$ 28,149</u> |

| | Nine Months Ended September 30, 2012 | | | |
|--|--------------------------------------|-----------------------------|---------------------|------------------|
| | Trading and Investing | Balance Sheet Management | Corporate/ Other | Total |
| Net operating interest income | \$ 492,456 | \$ 332,374 | \$ 4 | \$ 824,834 |
| Total non-interest income | 472,771 | 134,254 | (19) | 607,006 |
| Total net revenue | 965,227 | 466,628 | (15) | 1,431,840 |
| Provision for loan losses | — | 280,227 | — | 280,227 |
| Total operating expense | 580,113 | 168,407 | 128,207 | 876,727 |
| Income (loss) before other income (expense) and income taxes | 385,114 | 17,994 | (128,222) | 274,886 |
| Total other income (expense) | — | — | (184,655) | (184,655) |
| Income (loss) before income taxes | \$ 385,114 | \$ 17,994 | \$(312,877) | 90,231 |
| Income tax expense | | | | 16,755 |
| Net income | | | | <u>\$ 73,476</u> |

Segment Assets

| | Trading and Investing | Balance Sheet Management | Corporate/ Other | Total |
|--------------------------|--------------------------|-----------------------------|---------------------|---------------|
| As of September 30, 2013 | \$ 10,087,260 | \$ 34,868,901 | \$ 591,318 | \$ 45,547,479 |
| As of December 31, 2012 | \$ 9,505,280 | \$ 37,305,600 | \$ 575,859 | \$ 47,386,739 |

NOTE 17—SUBSEQUENT EVENT

On October 23, 2013, the Company entered into a definitive agreement to sell the market making business, G1 Execution Services, LLC, to an affiliate of Susquehanna International Group, LLP for approximately \$75 million. In addition, E*TRADE Securities LLC will enter into an order flow agreement whereby, subject to best execution standards, it will route 70% of its customer equity order flow to G1X over the next five years. This transaction is subject to regulatory approvals and other customary closing conditions and is expected to close in three to six months.

ITEM 4. CONTROLS AND PROCEDURES

- (a) Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 ("Exchange Act") Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly

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report, have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

- (b) Our Chief Executive Officer and our Chief Financial Officer have evaluated the changes to the Company's internal control over financial reporting that occurred during our last fiscal quarter ended September 30, 2013, as required by paragraph (d) of Exchange Act Rules 13a-15 and 15d-15, and have concluded that there were no such changes that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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Edwards et al., in Superior Court of Delaware, New Castle County, former Tribune employees and retirees claimed that Tribune was actually insolvent at the time of the LBO and that the LBO constituted a fraudulent transaction that depleted the plaintiffs' retirement plans, rendering them worthless. E*TRADE Clearing LLC, along with numerous other financial institutions, is a named defendant in this case, but has not been served with process. One of the defendants removed the action to federal district court in Delaware on July 1, 2011. In Deutsche Bank Trust Company Americas et al. v. Adaly Opportunity Fund et al., filed in the Supreme Court of New York, New York County on June 3, 2011, the Trustees of certain notes issued by Tribune allege wrongdoing in connection with the LBO. In particular the Trustees claim that the LBO constituted a constructive fraudulent transfer under various state laws. G1 Execution Services, LLC (formerly known as E*TRADE Capital Markets, LLC), along with numerous other financial institutions, is a named defendant in this case. In Deutsche Bank et al. v. Ohlson et al., filed in the U.S. District Court for the Northern District of Illinois, noteholders of Tribune asserted claims of constructive fraud and G1 Execution Services, LLC is a named defendant in this case. In EGI-TRB LLC et al. v. ABN-AMRO et al., filed in the Circuit Court of Cook County Illinois, creditors of Tribune assert fraudulent conveyance claims against multiple shareholder defendants and E*TRADE Clearing LLC is a named defendant in this case. 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 Company will defend itself vigorously in these matters.

During 2012, the Company completed a review of order handling practices and pricing for order flow between E*TRADE Securities LLC and G1 Execution Services, LLC. The Company has 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 and may initiate investigations into the Company's historical practices which could subject it to monetary penalties and cease-and-desist orders, which could also prompt claims by customers of E*TRADE Securities LLC. Any of these actions could materially and adversely affect the Company's broker-dealer businesses. On July 11, 2013, FINRA notified E*TRADE Securities LLC and G1 Execution Services, LLC that it is conducting an examination of both firms' routing practices.

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 LLC 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 September 13, 2013. The Company's demurrer and motion to strike the complaint are to be set for hearing December 20, 2013. The Company will continue to 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 reasonably estimate a range of possible losses on its remaining outstanding legal proceedings; however, the Company believes any losses would not be reasonably likely to have a material adverse effect on the consolidated financial condition or results of operations of the Company.

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

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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.

ITEM 1A. RISK FACTORS

The risk related to the regulation of our business presented below is updated from what was previously disclosed in our 2012 Annual Report on Form 10-K and should be considered in addition to all of the other risk factors disclosed in our 2012 Annual Report on Form 10-K.

Risks Relating to the Regulation of Our Business

If we fail to comply with applicable securities and banking laws, rules and regulations, either domestically or internationally, we could be subject to disciplinary actions, damages, penalties or restrictions that could significantly harm our business.

The SEC, FINRA and other self-regulatory organizations and state securities commissions, among other things, can censure, fine, issue cease-and-desist orders or suspend or expel a broker-dealer or any of its officers or employees. The OCC and Federal Reserve may take similar action with respect to our banking and other financial activities, respectively. Similarly, the attorneys general of each state could bring legal action on behalf of the citizens of the various states to ensure compliance with local laws. Regulatory agencies in countries outside of the U.S. have similar authority. The ability to comply with applicable laws and rules is dependent in part on the establishment and maintenance of a reasonable compliance function. The failure to establish and enforce reasonable compliance procedures, even if unintentional, could subject us to significant losses or disciplinary or other actions.

During 2012, the Company completed a review of order handling practices and pricing for order flow between E*TRADE Securities LLC and G1 Execution Services, LLC. The Company has implemented the 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 and may initiate investigations into the Company's historical practices which could subject it to monetary penalties and cease-and-desist orders, which could also prompt claims by customers of E*TRADE Securities LLC. Any of these actions could materially and adversely affect the Company's broker-dealer businesses. On July 11, 2013, FINRA notified E*TRADE Securities LLC and G1 Execution Services, LLC that it is conducting an examination of both firms' routing practices.

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.

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ITEM 6. EXHIBITS

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|----------|---|
| *31.1 | Certification—Section 302 of the Sarbanes-Oxley Act of 2002 |
| *31.2 | Certification—Section 302 of the Sarbanes-Oxley Act of 2002 |
| *32.1 | Certification—Section 906 of the Sarbanes-Oxley Act of 2002 |
| *101.INS | XBRL Instance Document |
| *101.SCH | XBRL Taxonomy Extension Schema Document |
| *101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| *101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| *101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| *101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed herein.

SIGNATURES

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

Dated: November 7, 2013

E*TRADE Financial Corporation
(Registrant)

By /s/ PAUL T. IDZIK

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

By /s/ MATTHEW J. AUDETTE

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

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

I, Paul T. Idzik, 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: November 7, 2013

E*TRADE Financial Corporation
(Registrant)

By _____ /S/ PAUL T. IDZIK
Paul T. Idzik
Chief Executive Officer
(Principal Executive Officer)

**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: November 7, 2013

E*TRADE Financial Corporation
(Registrant)

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

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

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

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

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

Dated: November 7, 2013

/s/ PAUL T. IDZIK

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

/s/ MATTHEW J. AUDETTE

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

