Corrected Transcript

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# E*TRADE Financial Corp. (ETFC)

Q2 2019 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good evening, and thank you for joining E*TRADE's Second Quarter 2019 Earnings Conference Call. Joining the call today are Chief Executive Officer Karl Roessner, Chief Operating Officer Michael Pizzi, and Chief Financial Officer Chad Turner.

Today's call may include forward-looking statements including statements about E*TRADE's future plans, objectives, outlook, strategies, expectations and intentions relating to its business, plans concerning capital deployment and future financial and operating results, and the assumptions that underlie these matters, strategic business initiatives including leveraging and extending its third-party sweep deposit arrangements and integrating its advisory custody platform, continued repurchases of its common stock, the benefits and flexibility of such repurchases, and outlook on the broader economic environment which reflect management's current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially.

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

This call will present information as of June 30, 2019 and July 18, 2019. The company disclaims any duty to update forward-looking statements made during the call except as required by law. This call is being recorded and a replay will be available via phone and webcast later this evening at about.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

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

## Karl A. Roessner

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

Thanks, Eric. Good evening, and thank you for joining us on our Q2 earnings call. As we passed the midway point of the year, we continue to build on strong business momentum across our retail and institutional channels. Within retail, our customers continue to meaningfully engage with the markets rotating amid the substantial fluctuations witnessed across the macro environment.

In the wake of strong trading activity and resilient margin and cash balances, we continue the steady drumbeat of product enhancements for our active traders while simplifying and streamlining our retirement and investing tools to make investing exceedingly simple.

In institutional, the second quarter was another hallmark period for Corporate Services, as the pace of new client wins remained exceptionally strong with $9 billion of newly implemented relationships we continue to extend our position as the industry leader.

With respect to capital return, we repurchased $222 million of our stock in the quarter, announced a new $1.5 billion authorization and began tactically shifting our balance sheet to free capital, which allows us to opportunistically repurchase additional stock at an extremely compelling value.

Finally, we are reaffirming our long-term EPS target of greater than $7 per share by 2023 as increased share repurchases and disciplined expense management help offset the interest rate pressures that have emerged in the last couple of quarters.

This past quarter continued to see pronounced market volatility, a common theme since the fall of last year. Concerns around international trade and global growth drove major indexes near correction territory in May before market surged to fresh highs in June. Interest rates were front and center as expectations from multiple fed cuts mounted throughout the quarter.

Throughout this period, our customers remained extremely engaged as both equity and derivative trades were at their highest volume for any Q2 on record. While the move in interest rates makes for a more challenging revenue environment, we continue to operate with the central tenet of creating the best possible experience for our customers, and in the second quarter, we made advancements across our suite of offerings.

We launched a new retirement planning hub that helps investors understand their financial picture and what gaps they may need to fill. We improved our automatic investing experience with a cleaner look and feel while lowering minimum contributions to a bite-sized $25, and we dropped the minimums for our robo-advisor and Prebuilt Mutual Fund Portfolios to $500. In short, we are breaking down barriers wherever we can on these already easy-to-use digital experiences so investors can engage with the markets regardless of experience level or wealth.

On Power E*TRADE, our award-winning active trading platform, we introduced new features like intraday technical pattern recognition and pre-defined watch lists to assist traders with idea generation. We also recently rolled out paper trading, giving customers the ability to test drive the platform and their trade ideas without committing capital.

As the intimidation factor is a persistent barrier to customer engagement with our more sophisticated tools, paper trading, along with our other educational offerings, serve as springboards to help our customers clear this hurdle.

Moving to the institutional side of the house, in May we held our annual Directions conference, which is the longest-running equity compensation conference in the industry. We hosted around 650 participants, including a significant population of prospective clients. This conference is a fan favorite of our clients where they can work closely with our team to learn about and test new enhancements, deliver feedback, and share insights with peers. Some enhancements that particularly resonate with clients include; seamless integration of client systems via APIs, financial reporting enhancements, and our automated 10b5-1 solution.

As for E*TRADE Advisor Services and our referral program, we continue to see great promise in this channel and are more than encouraged by the early interest from advisors and financial consultants alike. With that said, getting the integration of the custody platform right is of the utmost importance. And so while we have formalized the process and controls for FCs to link customers with advisors, we are still working through the middle and back office build-out to seamlessly handle the flows and activity. This has taken longer than initially anticipated, but we expect the integration to be complete in the first half of next year. We have also recently realigned management in this group, bringing on several industry veterans.

Now for our operating results. DARTs of 268,000 were up 7% from the year-ago quarter, but down 4% sequentially from the strong Q1. Derivative DARTs of 89,000 were up 4% versus the year-ago quarter and represented 33% of total trades. The buy the dip mentality was on full display as our retail customers were intense net buyers from early May through early June when the Dow and S&P pulled back 7% and the Nasdaq hit correction territory down more than 10% before meaningful profit-taking took hold in June, resulting in a very modest net buy position for the quarter.

July DARTs to-date have moderated slightly, currently down 2% from June. We generated net new retail and Advisor Services accounts of 34,000, down from last quarter's record. Net inflows of $1.6 billion reflected higher than usual pressures from tax season.

Corporate Services remains a white hot bright spot. We've generated 36,000 net new accounts or an 8% annualized growth rate. Gross inflows were a remarkable $25 billion with new implementations of $9 billion, our second best quarter ever. This brings our total implementations to $23 billion over the last 12 months. We grew total assets within Corporate Services channel to $259 billion, up 1% sequentially and 11% year-over-year.

On the capital front, as of the end of the second quarter, we had completed more than $800 million of our current $1 billion buyback authorization, and we plan to continue our robust pace of capital return, which is particularly accretive to EPS at the current stock price.

By leveraging our third-party sweep deposit arrangement and shifting deposits off-balance sheet, we can continue to grow our franchise and retain future earnings power from deposit growth, while directing capital to share repurchases today at extremely attractive valuations. We will take a fluid approach to the allocation of capital based on the prevailing economic environment and the value of our shares.

Before turning the call over to Mike and Chad, I want to spend a moment on our philosophy toward expense management and op margin. We continued to evaluate expenses through the same lens we use to look at all of our capital investment decisions. This means we will respond to the revenue landscape, directing investments in the manner that best serves franchise growth in consideration of long-term earnings power and shareholder value creation. We have a tremendously efficient and scalable business that allows for operating margin improvement as we grow the revenue base. By shifting our deposits off-balance sheet to third parties, we are sacrificing some revenue growth in the short term while increasing shareholder returns via share buybacks. But in doing so, we are prioritizing EPS growth and capital return over our margin.

Given our tremendous cash generation power, the most efficient way to grow EPS in the current environment is by combining our operating leverage and financial leverage where we pair business growth with extremely robust share repurchases.

To summarize, we are very pleased with the core results of the quarter and enhancements we continue to make for our customers and the flexibility to position E*TRADE for success no matter the environment.

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

## Michael A. Pizzi

*Chief Operating Officer & Executive Vice President, E*TRADE Financial Corp.*

Thanks, Karl. I would like to briefly address our tactical shift to managing our balance sheet and capital. In previous quarters, we've spoken about the flexibility afforded by our sweep program to move deposits to third-party banks in a manner seamless to our customers. This program expands FDIC insurance protection for our customers and gives us added capital capacity for deposits not held on our balance sheet. We are also in the process of developing the ability to treat bank deposits in a similar fashion.

Over the last year and a half, this off-balance sheet program held $3 billion to $4 billion in balances earning a gross yield modestly above the federal funds effective rate. Since the beginning of the year, interest rates have declined by 50 basis points to 75 basis points. The yield curve has flattened and even inverted at some points and the spread that we can earn on-balance sheet versus the fees we are on off-balance sheet has compressed. By directing deposit off-balance sheet, we can free capital for share repurchases which would otherwise be required to support customer deposits on-balance sheet. Given the flattening curve, we shifted $6.6 billion of deposits to third-party banks throughout the quarter, $4.5 billion of which related to our sales of lower-yielding securities.

If the current environment persists, we plan to direct new deposits off-balance sheet and can further shift existing deposits off-balance sheet as our investment portfolio turns over. As a reminder, we operate the bank at an internal capital threshold of 7%, which means for every 1 billion of bank deposits shifted off-balance sheet, we can free an additional $70 million worth of capital. Our business model generates very healthy excess capital at 80% to 90% of earnings when we are growing the balance sheet.

By diverting deposits off-balance sheet, we anticipate that our capital generation will be well in excess of earnings, allowing us to amplify buybacks at a point when it is highly accreted EPS. This is currently the most compelling path given the flatness of the yield curve and the low valuation of our stock and will remain the case even if short-term rates decrease. Similarly, this approach is accretive to ROE as new business growth comes free of capital commitment. Ultimately, we believe that EPS and ROE are the most important drivers of the stock, and we will take every appropriate action to maximize both measures through continued business growth and prudent capital actions.

The tactical shift, along with continued franchise growth and expense discipline, keeps us on pace to generate greater than $7 of EPS by 2023 even with the recent decline in rates. Our plan builds in two fed cuts by the end of this year and keeps fed funds flat at 2% through the end of 2023. Importantly, we retain the flexibility to shift our approach if the environment changes, and should the yield curve steepen, we can seamlessly shift deposit growth on-balance sheet when it is most economic.

Now I will turn the call over to Chad for a rundown of the quarter.

## Chad E. Turner

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

Thanks, Mike. For the quarter, we reported net income available to common shareholders of $219 million or $0.90 per diluted share on net revenues of $685 million. Included in the quarter was an $80 million pre-tax loss on securities or $0.24 per share impact related to the sale of $4.5 billion of lower-yielding investment securities in order to reduce our balance sheet and free capital. Offsetting this loss was an $8 million pre-tax or $0.02 per share benefit to provision for loan losses.

As per core results, net interest income decreased by $2 million sequentially as our net interest margin contracted by 3 basis points to 320 basis points and our average interest-earning assets grew by approximately $350 million.

Our NIM decline was driven by a 4-basis-point greater cost of funds offset by a 1-basis-point expansion in gross yield. Our blended deposit rate rose from 32 basis points to 36 basis points, driven primarily by growth in premium savings account balances. This rate includes both on- and off-balance sheet sweep deposits, bank deposits, and brokerage customer payables.

For Q3, we expect the blended deposit rate to be relatively flat to Q2. Our average reinvestment rate in the securities portfolio is currently 270 basis points to 290 basis points. For the full year, we still anticipate generating a NIM of 315 basis points to 320 basis points, consistent with our expectations we communicated last quarter. This guidance holds customer margin balances at their current levels, assumes deposits grow off-balance sheet, and contemplates one Fed funds rate cut in July and one cut in September.

A 25-basis-point move up or down in short-term rates beyond the cuts we have included in our NIM guidance would translate to a 3-basis-point annualized impact to NIM. Commission revenue of $121 million was down $1 million compared to last quarter driven by 11,000 lower DARTs and a $0.03 lower CPT offset by the benefit of two additional trading days. We continue to expect CPT to fall in the $6.90 to $7.30 range for the full year.

Fees and service charges of $126 million were up $16 million year-over-year and up $8 million sequentially as we benefited from more deposits off-balance sheet, a more profitable customer trade mix, and a handful of other seasonal factors. The average net yield on third-party cash was flat quarter-over-quarter with third-party money market fees of 53 basis points and third-party sweep deposit fees of 221 basis points, both net of deposit costs.

In Q3, we anticipate the gross fees on off-balance sheet sweep deposits will be around 240 basis points with net fees of approximately 210 basis points. We reported a net loss on sale of securities of $64 million, driven primarily by the $80 million of losses on securities sales. We expect to realize approximately $10 million of gains per quarter going forward.

Moving to expenses, non-interest expenses were $398 million. Compensation and benefits of $168 million was up sequentially, driven by $7 million of severance in the quarter related to the realignment of select teams. Marketing expense of $48 million was down $6 million from Q1. This quarter's adjusted operating margin which excludes provision benefit was 42%. The $80 million of losses on securities sales negatively affected the adjusted operating margin by approximately 6 percentage points. For the full year, we anticipate generating an adjusted operating margin of 46%. This includes a 1 percentage point net negative impact from the discrete items that we have communicated for the past two quarters, namely, the $80 million loss on securities sales this quarter, offset by the $14 million benefit on the communications line reported in Q1.

Our effective tax rate in the second quarter was 26%. We expect the full year 2019 rate to be between 26% and 27%. We finished the quarter at $380 million of corporate cash, reflecting $250 million in subsidiary dividends less the $222 million we used to repurchase our stock and the $34 million paid in common dividends.

As a reminder, we target holding a minimum of $300 million in corporate cash. We have $157 million remaining on our current buyback authorization and an additional $1.5 billion on our new authorization, which we plan to complete by the end of Q3 2020.

In closing, Q2 results were robust. Our position with customers is strong and the prospect for growth in our retail and institutional channels remains very positive. While the interest rate environment clearly presents challenges, we have both the financial and operating flexibility to navigate through this environment and continue to deliver compelling value for our shareholders.

With that, we will turn the call back to the operator for Q&A.

# QUESTION AND ANSWER SECTION

**Operator**: Thank you. [Operator Instructions] And our first question comes from Rich Repetto with Sandler O'Neill. Please go ahead.

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

Q

Yeah. Good evening, Karl, Mike, and Chad.

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

A

Hey, Rich.

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

Q

And I guess just a – good evening. So just a follow-up question on the sale of securities. So on this $4.5 billion sale, Mike, and just trying to understand how you -- on the loss, when rates were down in the quarter. And when you say you can continue to do this going forward, can you walk us through sort of how much more of an opportunity you have on the securities side, and the accretion, you say it's accretive. Can you walk us through sort of the math behind the accretive remarks that you've put around us?

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

A

Well, sure, Rich, I mean, here the securities we sold were lower-yielding securities that were on our balance sheet that come from yield curve environment in the past that were much lower. So you could think of them as investments that we made quite some time ago that we've been holding. They've been paying down a bit, but we still had quite a quite a number of lower yielding securities on the book.

When we look at that securities yield versus the sort of capital that we're holding, looking relative to the loss that we took, it became really quite clear that selling these to exceling the lower-yielding securities to accelerate an amount of capital return is clearly sort of in the best interest of shareholders if we look at it from an overall EPS and ROE perspective.

In terms of kind of further opportunity, there are still some securities in the book that are still relatively lower yields, but they would be a population higher than this population that we sold.

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

Q

Okay. We can just discuss it more. I guess the follow-up question would be Karl. So there's been these media reports about a potential wealth management transaction in the space. I know that's been an area of focus. And I guess could you review your guidelines and how you look at M&A and your appetite for wealth management capabilities and what metrics you'd use to sort of evaluate a deal?

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

A

Yeah, sure, Rich. I mean, we've been pretty clear on our position about M&A. First of all, we've run it through the same capital lens that we've talked about and looking at sort of the risk-free return as the bar or the hurdle we'd have to get to. So, not an easy hurdle to overcome in the current environment with our stock price where it is, particularly given the actions that we've just taken. But looking for us, it's focusing on scale. It's focusing on any opportunities that we might have around our stellar Corporate Services business, also around the services or other items that we provide out for the RIA custody population, right? So looking at sort of add-ons or bolt-ons, if you will. Nothing that I would currently comment on or go through, but our appetite has not changed and the focus hasn't changed.

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

Q

Okay. Thank you very much.

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

A

Thanks, Rich.

**Operator**: Our next question comes from the line of Brennan Hawken with UBS. Please go ahead.

Brennan Hawken
*Analyst, UBS Securities LLC*

Q

Good afternoon, guys. Thanks for taking the question. On the buyback, just curious about how we should think about it. I appreciate the comment around the timing. But is there a way we should think about this as far as stock prices and multiple impacting velocity, or is the pace of the buyback going to be pretty steady in a program-type approach?

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

A

I think you'll see sort of the way that we've approached it in the past will be the way that we approach it going forward. It will be done at a relatively measured pace over the next sort of 12-month period is what the authorization is for. Obviously, where there are opportunities for us to do a little more a little less, that's what we do, and we have some good advisors and we do put the appropriate plans in place to take care of that.

Brennan Hawken
*Analyst, UBS Securities LLC*

Q

Okay. Thanks. And then on the long-term earnings target, it's kind of hard to know this with precision because – but sort of eyeballing it here. When I look at the revenue growth component, you have that subset underneath. It looks like balance sheet growth as a contributor to revenue growth here didn't change much from your prior expectations. And so curious about how that squares with this plan to shift the deposits to the third-party banks and how it squares with your assumptions around the NIM guidance where I believe you said that all of the deposit growth would be off-balance sheet in that assumption. Do you guys then just sunset that after the year and then assume that it returns to balance sheet growth? How do those two seemingly different inputs square?

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

A

Yeah. So just starting, I'll actually start reverse order with your NIM question. So the guidance we gave of $315 million to $320 million, that was for this year, and I would really look at it as given the environment we're in now, the relative value of our stock and the dynamics between off- and on-balance sheet, that that $1.5 billion authorization over the next 12 months is our current intent.

When you look over the long term, which is what's on the greater than $7 slide, we believe there is value to having a balance sheet and that over time growing deposits on our balance sheet does provide the best source of value. That said, we would evaluate the environment at any given period over the five-year horizon to make sure we're making that decision correctly, but I would note that on the long-term earnings slide, with the multiples expanding, for example, in that illustration, you would be growing your balance sheet versus buying back stock over the entire horizon.

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

A

Once we get past this $1.5 billion, we begin in a measured way in the outer years to grow the balance sheet again. Obviously though as indicated in my prepared remarks, we have the flexibility really to do what is right in the environment that we encounter at that time and where we would take the action therefore accordingly as to whether we would continue with aggressive capital return or begin to move deposits back on-balance sheet.

Brennan Hawken
*Analyst, UBS Securities LLC*

Q

Okay. Thanks for that color.

**Operator**: And our next question comes from the line of Steven Chubak with Wolfe Research. Please go ahead.

Steven Chubak
*Analyst, Wolfe Research LLC*

Q

Hi. Good evening.

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

A

Hey, Steven.

Steven Chubak
*Analyst, Wolfe Research LLC*

Q

So I want to start off with a question on the marginal margin of 70% to 75% that's contemplated as part of the EPS law. Now if I exclude the impact of the securities sales this quarter, revenues were up about 5% year-on-year, expenses up 3.5%, and that implies a marginal margin somewhere around 35%. And I'm just wondering, what are some of the factors driving some of the pressure on that incremental margin today and how do we start – and what's going to prompt some improved momentum to get that building somewhere closer to the 70% to 75% from here?

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

Yeah. The 70% to 75%, I would describe that as total revenue. And so depending on the type of revenue growth you're seeing, whether that's coming from cash which is obviously at a much higher margin versus some of our other projects or revenue streams that could be a bit lower, that's going to have that ebb and flow in any given period. Obviously, we've been in an environment over the trailing 12 months where cash growth has been low. We've had, we've had record net buying and so, a lot more cash is being put to work in the market by our customers. So, that's really where over the five-year horizon of the long term earnings slide, you would expect to see that $70 million to $75 million as you're growing the balance sheet, acknowledging any given period could be a bit different depending on mix.

Steven Chubak
*Analyst, Wolfe Research LLC*
Q

And just one more question for me on expense flexibility. The core net new asset growth had slowed a little bit this quarter. Just given some of the pressures in a more challenging operating backdrop, you talked about slowdown in engagement in July. How does it inform the approach to fluxing expenses? And I know, Paul, you talked about your ability to maybe flex marketing spend, its run rating at least in the first half a little bit above that $200 million. I'm wondering if we should expect that the weakness in activity persist that you're going to look to flex at maybe a little bit more aggressively from here.

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

So, look, it's a good question, Steven, and it's something that we're obviously focused on as a management team and we talk about quite often. We do have the ability to flex marketing even going into the end of the year, follow those contracts and things are cancelable. But what we have seen and have had a lot of success with of late is that the dollars within marketing to get – not spent on the big ticket advertising or other pieces but it's more around digital marketing and more around the offers and sort of third-party matches that we've going through as we compete for additional business at the higher end of the book, right, at some of the offers that you're going out to your customers with. So all in all we're quite pleased with where we are right now.

And also on expense discipline, I would say just – we don't just focus on the marketing line in terms of throttling that, call it $200 million up and back. There are a lot of levers that we have here with respect to expense discipline and what we can pull back on. So when we look at projects that we invest in, what's going to drive revenue, how should we be prioritizing the things that we're doing within the firm? What are we doing with respect to head count adds? Can we do more with less? So there are a lot of decision points that go on to that line, Steven, and I can guarantee you that this team is extremely focused on it.

Steven Chubak
*Analyst, Wolfe Research LLC*
Q

Great. Thanks for taking my questions.

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

Thanks, Steven.

**Operator**: Our next question comes from the line of Christian Bolu with Autonomous Research. Please go ahead.

Christian Bolu
*Analyst, Autonomous Research*

Q

Good evening, guys. Sorry. I guess, I don't know if I missed this, but the operating margin target for 2020, are you still expecting 50%?

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

A

No. We didn't give an update on that, Christian. This is Chad. As Karl had mentioned in his prepared remarks, moving to the off-balance sheet dynamics where you're giving up a bit of that yield difference between on and off to free up capital, that is going to allow you to pick EPS and ROE as the more important levers in this environment and obviously what we look at more long term. So the operating margin for 2020 would definitely be lower than that based on that decision.

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

A

Yes. And just to be clear then, we have absolutely with the moves that we've made and the flexibility in our model that's allowed us to make the moves that we have and just announced. We've clearly prioritized EPS growth and capital return over our op margins in the short term, but we are not coming off our longer-term operating margin guidance just because of the amount of leverage we can drive through this business and what we believe that we can get done. So over the longer term, we still absolutely anticipate that we'll be in excess of 50% on the op margin side.

Christian Bolu
*Analyst, Autonomous Research*

Q

If I may, I guess, following-up on that, Karl. Again, totally understand why you can you can hit 50% margin target for 2020, but thinking back to obviously October 2018 growth targets as well where there was a miss, how do you help convince investors that you can actually see 2023 targets when the first signpost, the first signpost which is our target has effectively been missed?

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

A

Yeah. So I wouldn't – I don't phrase it as a miss and I'm not necessarily worried about confidence in terms of what we're going to deliver. I think what we've put on the table this evening shows that we've taken action in a time where we believe that this is the best return for our shareholders over time, right? So we've taken the engine that we've talked about, having a great degree of flexibility, that being our business model, and really put it to the test, right?

We've gone to the off-balance sheet route that we've had in the works for quite some time. I was able to move off with ease, and be able to still hit the $7 that we've announced of EPS, and we've looked at long-term shareholder value over a short-term op margin.

So expense discipline has been something that we've shown and demonstrated over the past few years, we'll continue to do that. But we did give up some short-term earnings and some short-term revenue growth in order to do what we've done on the capital side. I don't know, Mike, if you want to add something to that.

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

Yeah. Look, I think what we're announcing here tonight is very significant in terms of the amount of capital return, especially when you look at that and on a cumulative basis to the existing billion-dollar authorization. What that means from a relative value in terms of the multiple of the stock, we will – and sort of a permanent reduction in the share count against the earnings power really being in the firm, just shifting resources from a balance sheet side to the off-balance sheet side. This goes a long way to driving us towards our goal, and I think you're going to see us continue to take the right set of actions to drive value creation over time.

Christian Bolu
*Analyst, Autonomous Research*
Q

Okay. Thank you.

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

Thanks, Christian.

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

Devin Ryan
*Analyst, JMP Securities LLC*
Q

Great. Good afternoon, guys.

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

Hi, Devin.

Devin Ryan
*Analyst, JMP Securities LLC*
Q

So just one on cash balances here, obviously good to see that move higher and it sounds like some selling boosted cash at quarter-end. I'm just curious what you're seeing on sorting behavior specifically right now as you're evaluating what customers are doing kind of with the remaining cash in their accounts, and whether you have any updated expectations on that specifically on the sorting side.

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

Yeah. The one thing I would say, I'm going to pass it over to Chad for the specifics, Devin, but on the cash sorting side, we're still seeing our customers being remember the proportion of cash and the size of the cash that's in some of these accounts and the accounts that we have in that sort of sub-$10,000 range that sits in cash, that's really investing cash. So we don't have a lot of the behaviors that you might see, where we'd go into money funds or money markets. We've obviously had quite a good product in the PSA that we've been able to roll out, but, Chad, I'll let you go through the specifics.

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

Yeah. Devin, I think the simplest example to give you is we -- around just the fact that we have not seen any material impact in customers that are yield-seeking on that front is that a fraction of 1% of our overall accounts have actually even purchased the money fund or a very short-term EPS fund in their accounts.

So it's just not something we see, to Karl's point. The majority of the cash from our customers is that frictional cash that's just coming in and out of the market, and so they remain relatively rate-unsensitive. They do not broadly look at cash as an asset class for them at E*TRADE in that sense. For those that do, they are able – the premium savings is an example of something that's been successful there where we've been able to retain some of those customers that are looking for a bit more fast yield there.

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Devin Ryan
*Analyst, JMP Securities LLC*

Q

Yeah. Okay. Great. And then just a follow-up [indiscernible] (00:35:21) on the excess capital position, but on the buyback, specifically in incremental authorization, as you think about the sizing of that, do you guys have line of sight into that capital creation purely from earnings and capital freed up from the recent securities sales, or is that kind of sized with the thought of additional securities sales or maybe even said a different way? If there are additional securities sales over the next year or so, does that actually just create additional dry powder that [indiscernible] (00:35:50)?

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

A

Kevin, the sale that we've done is sufficient really from a capital and dividend perspective with the earnings that we're expecting to fund additional dividends in the out quarters to complete the buyback over the course of its authorization or the one-year period. We don't need to sell additional securities. We have factored in the modest degree of paydowns we receive and assume that we continue some degree of off-balance sheet from securities paydowns but that will not come through via additional sales. So any additional sales could generate additional capacity.

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Devin Ryan
*Analyst, JMP Securities LLC*

Q

Yeah. Okay. Great. Thank you.

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**Operator**: Our next question comes from the line of Kyle Voigt with KBW. Please go ahead.

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

Q

Hi. Good evening. Just a question on deposit betas. You've previously talked about betas in the range of 20% on the way up and down. But now you're potentially approaching that first fed cut and some competitors are already starting to move on deposit rates. Does that help inform your view of whether betas could be a bit higher for this first couple of cuts here?

And then kind of like a second part of that question, you start to break out some of the rates on your savings products separately. How do you think about the betas that relates to that product specifically in a rate-cut environment?

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

A

Hey, Kyle. Yeah. So just on the overall sweep deposit beta, that 20% that we've quoted is pretty consistent on the up and down acknowledging that the competitive environment and us evaluating what the peers set is doing is something that we take into account, but 20% is a good number there.

Obviously to your point, the beta on our premium savings account is significantly higher just given the type of product that it is, and so if that's going to be a lot more yield-sensitive as the fed cuts. We did break that out, not only on the yield table but also in the footnotes to make sure you can see what the premium savings balances as you're evaluating the impact on any sort of fed moves.

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

Q

And I just have a follow-up on the off-balance sheet cash, I guess with the fed curve suggesting maybe three cuts by the end of the year. Just wondering if there's anything that you could do to lock in rates in the third-party banks or if we should just think about the yield as repricing rather quickly as rates move lower.

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

A

Yeah. I mean, we think that the best thing to do is to leave it predominantly floating and give us a lot of flexibility to move the cash and respond to the environment. We do have the capacity to put on term agreements, but looking at sort of where those would be right now relative to sort of the efficiency of the forward curve, we don't think that is the kind of right thing to be doing here.

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

Q

Great. Thank you very much.

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

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Will Nance
*Analyst, Goldman Sachs & Co. LLC*

Q

Hey. Good evening, guys. Maybe one on the mechanics of the capital-light strategy. So I realize this will generate a lot of excess capital but I think the transaction itself, not today's transaction, but just the nature of moving things off-balance sheet and running down securities is probably net neutral to cash, if I'm thinking about that right. So I guess in the context of this strategy, driving you guys to potentially pay out more than 100% of earnings, how do you think about generating corporate cash, and do we need to think about some sort of incremental funding to go along with that buyback?

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

A

The reduction in capital requirements from the securities sales supports a larger dividend in the first quarter that will fund the purchases. So dividends from both the bank and the broker-dealer in the period set up incremental capital flows.

From a corporate liquidity perspective, our corporate cash target of $300 million remains intact and we will always manage to that target of maintaining $300 million of corporate liquidity at all times. So those are really the mechanics. And if you sort of model that out, I think you'll see that there's quite a bit of capital that has been freed up that will support the buyback program over the period.

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**Will Nance**
*Analyst, Goldman Sachs & Co. LLC*

Q

Got it. Okay. And then I guess my follow-up is – when I think about what you did this quarter, moving predominantly sweep deposits off-balance sheet, I think if I heard you correctly you're in the process of working on the banking related balances as well. Is it a fair assumption that once that is set up, the much higher-yielding premium savings would be a pretty good candidate to move pretty quickly? Just think about the incremental margin on those. What are your thoughts there?

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

A

That's correct. I mean, if you think about it, the systems or underlying technology of the bank accounts is different than the sweep deposits. So it doesn't have that sort of off-balance sheet, on-balance sheet multi-charter capability. We are building that out across the bank products, specifically the premium savings product first.

In today's yield curve environment, it really doesn't make a lot of difference in terms of which one you choose to move off. Obviously, you're getting better floating rates than sort of the belly of the curve at this point anyway. But if we have a more normalized curve or some steepness to the curve, then I think you'll see very clearly that it makes sense to move the premium savings money versus the sweep deposits.

So building that out will give us really the ultimate flexibility in terms of deciding what cash to have off-balance sheet versus on-balance sheet to maximize sort of the return potential of the overall profile and the return we're getting on the bank's capital.

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**Will Nance**
*Analyst, Goldman Sachs & Co. LLC*

Q

Got it. All right. Thanks for taking my questions.

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

A

Thanks, Will.

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

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**Christopher Harris**
*Analyst, Wells Fargo Securities LLC*

Q

Thanks. Hi, guys. Looking at your fees and service charges line item that was a positive surprise versus what we're expecting. If we backed out the fees you get from the off-balance sheet cash, you had 6% sequential growth in that line item this quarter on top of 8% sequential growth last quarter. So we can see the individual line items, but just bigger picture, what is driving the growth in that? I mean, it just seems pretty impressive. And just wondering how sustainable that level of growth rate is for that particular line item?

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

A

Sure, Chris. So, yeah, obviously, every individual line is a bit different, I'd note, on the order flow side. We have seen DART mix or it'd be more skewed towards derivatives for example this quarter, so even though we saw a bit of it moderate, we did see the derivative piece hold up pretty well there. You can also have a little bit of a mix impact inside of that that can drive that. So I would describe that as a bit more nuanced around the type of trading environment we see.

On the advisor management and custody fees, we do believe that that will continue to grow, right? That's our managed product portfolio, and the good growth we've seen there as well as everything you heard Karl talk about on the Advisor Services piece where this is the existing custody fees we get from Advisor Services and we only expect that to grow as we continue to build out that platform and the referral network. So I think you'd see some there.

And then there is a bit of cyclicality around FX as it relates to Corporate Services that can – if you look over time you can see how that can kind of go up and down in any given period. That's a little bit of color there. But obviously as we grow off-balance sheet, that will be the largest impact to this at least over the short term.

Christopher Harris
*Analyst, Wells Fargo Securities LLC*

Q

Okay. And the earlier comment about the middle and back office build out that's still going on in advisory, does that mean we shouldn't really be expecting much in the way of flows until like the latter part of 2020?

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

A

Yeah, I think, look, that's a pretty fair assumption. The way that that's breaking down is that the Advisor Services business, the [ph] LTCA (00:43:57) custody platform that we have is quite suitable, quite capable, and it's a very nice piece of technology for the underserved sort of portion of the RA market, that's like the $500 million or less sort of under custody. And as we look to build out more or onboard more, we need to make that process a lot more seamless. And as we build out the referral network, we have the two primary RIAs who have come on board and then we have the FC network that's been built out. But putting together all that functionality to make the onboarding for those referral clients extremely seamless and easy, right, those are E*TRADE clients and customers coming through those gates. So that needs to be perfect.

We're taking our time. We're doing it the right way. We're building out a very nice model for that, so that we can scale it up quite a bit. So, the commitments that we've had and that we talked about earlier on, those commitments are still in place. But you shouldn't expect to see anything until sort of that latter half of 2020 in terms of meaningful growth.

Christopher Harris
*Analyst, Wells Fargo Securities LLC*

Q

Got it. Thank you.

**Operator**: Our next question comes from the line of Jeremy Campbell with Barclays. Please go ahead.

Jeremy Campbell
*Analyst, Barclays Capital, Inc.*
Q

Many thanks, guys. Most were asked and answered here. Just got a quick clarifying question for you, Chad. When you said I think an additional 25-basis-point cut relative to your two-cut scenario would be 3-basis point impact on NIMs. Was that relative to your full-year 2019 guide or is that you're like run rate annualized going forward?

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

Yeah. I would describe that as looking at the interest rate sensitivity that we provide you on page 21. That's really where that's coming from. That takes our interest-earning assets as of the end of the quarter and gives you that sensitivity. So if the overall interest-earnings assets were to grow or to shrink, you would deploy that a little differently. That's just on our static balance sheet at that point.

Jeremy Campbell
*Analyst, Barclays Capital, Inc.*
Q

Okay. So that's more of a run rate go-forward then. It's not relative to the full year 2019 guide.

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

That's correct.

Jeremy Campbell
*Analyst, Barclays Capital, Inc.*
Q

Great. Thank you.

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

It's a discrete calculation just as of that point. That's right.

Jeremy Campbell
*Analyst, Barclays Capital, Inc.*
Q

Perfect. Thank you.

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

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

All right. Thanks. Just one question on expenses, I understand the margin dynamics with the balance sheet move and the buyback focus. But just on the core expenses, I guess any guidance on how we should be thinking about the overall level? And I might have missed it but did you guys give the amount – I think you mentioned there was some severance in the comp, I'm not sure if you gave that level.

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

A

Yeah. Michael, we talked about $7 million being in comp in the quarter that you could take that as an unusual item. So other than that, the expenses, it was relatively clean, not much to talk about there. Just giving you a little bit of food for thought as it relates to going forward, we've talked about that flexibility tactically in any given period. I would also note that protecting our operating margins over the long term is not necessarily just around cutting in nuanced ways in any given period, but it's really more around focusing on cost containment and how we remain efficient as a firm. Our industry-leading operating margins do come from our business model being a bit more digitally-centric than the peer set which enables us not just to invest in growth on the revenue side but also to invest in areas where we can be a lot more efficient as the business grows that we can be more efficient around how we have to add expenses. You've heard Mike talk about that on the ops and tech side before. Those are just examples of how we think about that of investing not only for growth but also for efficiency.

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Michael Carrier
*Analyst, Bank of America Merrill Lynch*

Q

Okay. Thanks a lot.

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

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Brian Bedell
*Analyst, Deutsche Bank Securities, Inc.*

Q

Great. Thanks. Good afternoon, folks. I'm sorry if I missed the detail on this, but can you just talk about the accretion expectations from the balance sheet move in the near term and the sensitivity if we are in an environment where the short-term rates, let's say the fed cuts much more aggressively over the next year than [ph] the two moves (00:48:22), but the yield curve steepens on the basis of the fed cuts. So how that sort of sensitivity changes and then would that lead you to bring those deposits back on the balance sheet?

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

A

Sure. We didn't give you the exact accretion on expectation, but I think you can sort of imply that the buyback will occur over the course of really the next 12 months. We will really target it at a relatively measured pace, but try to be as tactical as possible within that measured pace. The securities that we sold were around $220 million yield on the $4.5 billion. And right now without a fed cut, we're earning a little over the fed funds effective rate on the off-balance sheet portion. We have provided updated rate sensitivities in the investor deck. I would think that for movements to the fed rate, they're going to be relatively linear on the short side, meaning if there are multiple cuts over time, that you can use that sort of estimate the change in net interest income on the balance sheet over the next 12 months, and then what happens to the off-balance sheet as well. Obviously, if this is a typical life cycle and we see a broad steepening of the curve, we have the capability of moving those balances back on-balance sheet to preserve revenue generation.

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Brian Bedell
*Analyst, Deutsche Bank Securities, Inc.*

Q

Okay. Okay. And then switching over to the expense outlook. So just back to 2020, obviously we're not looking at 50-plus margin, but what type of operating margin are you thinking is appropriate or you think you can achieve in 2020 with this new revenue dynamic?

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

Yeah, that's not something we're guiding to today for 2020. I'd just note that we continue to be pretty thoughtful on the expense side. I think you can do a bit of the revenue side math just based on what Mike just gave you around the give-up on the balance sheet side versus what you get off and kind of what those dynamics are. But on the expense side, that's really around what we talked about is how do we not only find ways to be smart with the incremental new investment dollars but how are we making sure that we're containing cost in a moderate revenue environment like that. So that would be a little bit of a qualitative comment I'd put around what we think about 2020.

Brian Bedell
*Analyst, Deutsche Bank Securities, Inc.*
Q

So if you're looking for expense levels to stay roughly flattish, ex the severance and then, of course, advertising can flex back and forth?

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

Nothing we're guiding to now. I think as we move towards getting into 2020, we can give you a bit more of an update there.

Brian Bedell
*Analyst, Deutsche Bank Securities, Inc.*
Q

Got it. And then just one last one on month-to-date DARTs, if you could disclose that?

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

It was down about 2% from June. It's from June as what we said in the prepared remarks.

Brian Bedell
*Analyst, Deutsche Bank Securities, Inc.*
Q

I'm sorry I missed that. Okay. Thank you so much.

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

Sure.

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

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

Hey. Good evening. Thanks for taking the question. Just on the balance sheet strategy, so you've shifted a bit already off the balance sheet to third parties. I guess would you ever consider a strategic relationship or partnership to improve the efficiency of the balance sheet by shifting even more cash off-balance sheet in a much more meaningful way?

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

A

Yes. So I think the business model that we have sort of demonstrates its value in multiple scenarios and across multiple markets. I think we've demonstrated our ability to take advantage of the model just with the actions we've done to go out balance sheet and return additional capital to our shareholders, obviously in a rising rate environment that we've been in in the past couple of years. The revenue growth has been quite outstanding from my own perspective. So I think we're quite happy with the current model, not pursuing anything on that strategic front. I think we talked about this quite a bit in terms of what our acquisitions or partnerships might look like. So I think our model we're pretty happy with right now.

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

Q

Okay. Great. And then just a quick follow-up on the $7 share target by 2023, I think you were assuming that fed funds held at 2% beyond two cuts this year. I guess if the fed were to cut to zero, how should we think about how different that $7 figure might look. How should we think about NIM bottoming out in that sort of environment?

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

A

I mean, the one thing I would say is when we go through this when we were asked, I think even when Mike Pizzi and I were out before bringing Chad in as CFO, when we talk to investors about some of this plan, it was around – if we go low for long or we go to zero, obviously the long-term plan is extremely challenged. So I don't know, Chad, if you want to give some color around that but that was...

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

A

Yeah. Yeah, I mean, the rate sensitivity in the investor deck for short-term rate cuts, it's obviously pretty linear all the way to zero. So you would lose that on the way down. That said, I think as it relates to the long-term earnings slide, it really depends on what happens to the overall yield curve and what that looks like to make other decisions around what you'd be able to invest on your balance sheet. So there's lots of nuances to that. Certainly if there's parallel shifts down or significant cuts from the fed that get near zero, we are an asset-sensitive balance sheet and that would have impact on long-term earnings.

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

Q

Yeah. Okay. Thank you.

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

A

Sure.

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

Craig Siegenthaler
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Good evening, guys. So in the prepared remarks, you said you expect deposit rates to be flat, I believe, despite assuming a July fed rate cut. But just to clarify, with a 25-basis-point rate cut, do you still expect deposit sweep rates to be flattish in the end of third quarter? And also if we have a second rate cut, what should be the beta or change in the blended deposits with the second cut?

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

Yeah, we guided that we would have a rate cut in July and we follow those 20% betas for the sweep -- for the non, let's call it premium savings deposits, and then you can -- obviously a lot more sensitive on the premium savings side. That would be flat. If you move to another fed cut, I think you can just apply, as we've said, apply those same 20% betas on the sweep deposits and brokerage cash.

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**Craig Siegenthaler**
*Analyst, Credit Suisse Securities (USA) LLC*
Q

Okay, helpful. And then just my follow-up, just given the lower net new asset generation 2Q versus the last few quarters, any thoughts on the run rate in the back half of the year?

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

I mean, look, in terms of generation, in terms of where we are on net new assets, I think this quarter was impacted by some outsized cash outflows around the payment of taxes, right, with some of the tax reform that went on. We definitely saw some outside taxes. The thing that I look at and we look at as a firm in terms of inflows coming in, right, what we've done on the Corporate Services side, the amount of assets that have been onboarded into that pipeline. Our Advisor Services business going out into 2020 and the assets, that will continue to generate. And our core business remains extremely healthy. So I don't have updated guidance on that, Chad. I don't believe you give numbers on that, but I think we look at this quarter as seasonally low.

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

Yeah. That's right and you could see that cyclically if you look over time, so we haven't guided to the rest of the year, but I would note that we have given our views on what long-term growth rates for both assets and accounts should look like over the long period of time. We believe those are still reasonable for our business and would expect to have the overall period to look like that.

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**Craig Siegenthaler**
*Analyst, Credit Suisse Securities (USA) LLC*
Q

Thank you.

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**Operator**: And we have no further questions from the phone lines at this time. I'll turn the call back to your hosts.

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

Well, thank you, all, for joining us this evening, and we look forward to talking to you in the quarter. Have a good evening.

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