

E TRADE FINANCIAL CORP  
Form 10-Q  
August 03, 2017  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

FORM 10-Q

---

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

For the quarterly period ended June 30, 2017

Commission File Number 1-11921

---

ETRADE Financial Corporation  
(Exact Name of Registrant as Specified in its Charter)

---

Delaware	94-2844166
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1271 Avenue of the Americas, 14 <sup>th</sup> Floor, New York, New York 10020	
(Address of principal executive offices and Zip Code)	
(646) 521-4300	
(Registrant's telephone number, including area code)	

---

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth 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"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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 July 31, 2017, there were 274,709,880 shares of common stock outstanding.



Table of Contents

E\*TRADE FINANCIAL CORPORATION

FORM 10-Q QUARTERLY REPORT

For the Quarter Ended June 30, 2017

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1.	Condensed <u>Consolidated Financial Statements (Unaudited)</u>	41
	Condensed <u>Consolidated Statement of Income</u>	41
	Condensed <u>Consolidated Statement of Comprehensive Income</u>	42
	Condensed <u>Consolidated Balance Sheet</u>	43
	Condensed <u>Consolidated Statement of Shareholders' Equity</u>	44
	Condensed <u>Consolidated Statement of Cash Flows</u>	45
	<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	47
	<u>Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies</u>	47
	<u>Note 2—Interest Income and Interest Expense</u>	51
	<u>Note 3—Fair Value Disclosures</u>	51
	<u>Note 4—Offsetting Assets and Liabilities</u>	60
	<u>Note 5—Available-for-Sale and Held-to-Maturity Securities</u>	62
	<u>Note 6—Loans Receivable, Net</u>	65
	<u>Note 7—Derivative Instruments and Hedging Activities</u>	74
	<u>Note 8—Deposits</u>	75
	<u>Note 9—Other Borrowings</u>	76
	<u>Note 10—Corporate Debt</u>	77
	<u>Note 11—Shareholders' Equity</u>	78
	<u>Note 12—Earnings Per Share</u>	80
	<u>Note 13—Regulatory Requirements</u>	81
	<u>Note 14—Commitments, Contingencies and Other Regulatory Matters</u>	83
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	1
	<u>Overview</u>	2
	<u>Earnings Overview</u>	9
	<u>Balance Sheet Overview</u>	18
	<u>Liquidity and Capital Resources</u>	21
	<u>Risk Management</u>	29
	<u>Concentrations of Credit Risk</u>	29
	<u>Summary of Critical Accounting Policies and Estimates</u>	32
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	34
	<u>Key Terms</u>	37
Item 4.	<u>Controls and Procedures</u>	87
PART II <u>OTHER INFORMATION</u>		
Item 1.	<u>Legal Proceedings</u>	88
Item 1A.	<u>Risk Factors</u>	88
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	88
Item 3.	<u>Defaults Upon Senior Securities</u>	88
Item 4.	<u>Mine Safety Disclosures</u>	88
Item 5.	<u>Other Information</u>	89
Item 6.	<u>Exhibits</u>	89
	<u>Signatures</u>	90

E\*TRADE | Q2 2017 10-Q i

---

Table of Contents

Unless otherwise indicated, references to "the Company," "we," "us," "our," "E\*TRADE" and "E\*TRADE Financial" mean E\*TRADE Financial Corporation and its subsidiaries, and references to the parent company mean E\*TRADE Financial Corporation but not its subsidiaries.

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

E\*TRADE | Q2 2017 10-Q ii

---

Table of Contents

PART I

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. These statements discuss, among other things, our future plans, objectives, outlook, strategies, expectations and intentions relating to our business and future financial and operating results and the assumptions that underlie these matters and include statements regarding our business strategy, objectives and vision; our plans and ability to deliver new products and solutions; our ability to improve client acquisition and deepen relationships with existing clients; our ability to effectively monetize brokerage relationships by investing in agency mortgage-backed securities; our capital plan initiatives, the expected balance sheet size, any balance sheet growth and the incremental regulatory and reporting requirements that our balance sheet size and growth may require; our plans to run off our legacy loan portfolio; repurchases of our common stock, payment of dividends on our preferred stock; our ability to maintain required regulatory capital ratios; our plans for the payment of dividends from our subsidiaries to our parent company; our ability to identify and manage risks appropriately; and any other statement that is not historical in nature. These statements may be identified by the use of words such as "assume," "expect," "believe," "may," "will," "should," "anticipate," "intend," "plan," "estimate," "continue" and similar expressions. We caution that actual results could differ materially from those discussed in these forward-looking statements. Important factors that could contribute to our actual results differing materially from any forward-looking statements include, but are not limited to, changes in business, economic or political condition; performance, volume and volatility in the equity and capital markets; fluctuations in interest rates; customer demand for financial products and services; increased competition; cyber security threats, potential system disruptions and other security breaches; our ability to participate in consolidation opportunities in our industry; the ability to realize synergies or to implement integration plans and other risks from mergers and acquisitions; our ability to service our corporate debt; changes in government regulation or actions by our regulators; our ability to move capital to our parent company from our subsidiaries; adverse developments in litigation or regulatory matters; the timing and duration of, and the amount of shares repurchased and amount of cash expended in connection with, the share repurchase program; and other factors discussed under Part II. Item 1A. Risk Factors and Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q; and Part I. Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2016, filed with the Securities and Exchange Commission (SEC), which are incorporated herein by reference. By their nature forward-looking statements are not guarantees of future performance or results and are subject to risks, uncertainties and assumptions that are difficult to predict or quantify. Actual future results may vary materially from expectations expressed or implied in this report or any of our prior communications. The forward-looking statements contained in this report reflect our expectations only as of the date of this report. You should not place undue reliance on forward-looking statements, as we do not undertake to update or revise forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made, except as required by law.

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

The following discussion should be read in conjunction with the consolidated financial statements and the related notes that appear elsewhere in this document and with the Annual Report on Form 10-K for the year ended December 31, 2016.

## Table of Contents

### OVERVIEW

#### Company Overview

E\*TRADE is a financial services company that provides online brokerage and related products and services primarily to individual retail investors. Our mission is to enhance the financial independence of traders and investors through a powerful digital offering and professional guidance. Our vision is to be the #1 digital broker and advisor to traders and investors, known for ease of use and the completeness of our offering.

#### Strategy

Our business strategy is centered on two key objectives: accelerating the growth of our core brokerage business to drive organic growth and improve competitive position, and generating robust earnings growth and healthy returns on capital to deliver long-term value for our stakeholders.

#### Accelerate Growth of Core Brokerage Business

##### Enhance overall customer experience

We are focused on delivering cutting-edge trading solutions while improving our market position in investing products. Through these offerings, we aim to drive customer acquisition while deepening engagement with our existing customers.

##### Capitalize on value of corporate services channel

We leverage our industry-leading position in corporate stock plan administration to improve client acquisition and engage with plan participants to bolster awareness of our full suite of offerings. Our corporate services channel is a strategically important driver of brokerage account and asset growth.

#### Generate Robust Earnings Growth and Healthy Returns on Capital

##### Utilize balance sheet to enhance returns

We utilize our bank structure to effectively monetize brokerage relationships by investing stable, low-cost deposits primarily in agency mortgage-backed securities.

##### Put capital to work for shareholders

We have put significant capital to work through balance sheet growth, share repurchases and acquisition activity. We are focused on generating and effectively deploying capital for the benefit of our shareholders.

#### Financial Performance

Our net revenue is generated primarily from net interest income, commissions and fees and service charges. Net interest income is largely impacted by the size of our balance sheet, our balance sheet mix, and average yields on our assets and liabilities. Net interest income is driven primarily from interest earned on investment securities and margin receivables, less interest paid on interest-bearing liabilities, including deposits, customer payables, corporate debt and other borrowings. Net interest income is also earned on our legacy loan portfolio which we expect to continue to run off in future periods. Commissions revenue is generated by customer trades and is largely impacted by trade volume and commission rates. Fees and service charges revenue is mainly impacted by order flow revenue, fees earned on off-balance sheet customer cash and other assets, and advisor management fees. Our net revenue is offset by non-interest expenses, the largest of which are compensation and benefits and advertising and market development.

Table of Contents

Significant Events in the Second Quarter of 2017

Consolidated Tier 1 leverage ratio threshold reduced to 6.5%

Beginning July 2017, E\*TRADE Financial's consolidated Tier 1 leverage ratio threshold is 6.5%, which was reduced from the previous threshold of 7.0%.

Authorized the repurchase of up to \$1 billion of shares of our common stock

In July 2017, we announced that our Board of Directors authorized the repurchase of up to \$1 billion of shares of our common stock. The timing and exact amount of any common stock repurchases will depend on various factors, including market conditions and our capital position. As of July 31, 2017, we have subsequently repurchased 0.7 million shares of common stock at an average price of \$41.24 for a total of approximately \$26.8 million.

Launch of new advertising campaign - Don't Get Mad, Get E\*TRADE

We launched a new advertising campaign, Don't Get Mad, Get E\*TRADE. This campaign acknowledges the everyday frustrations that consumers feel when bombarded by depictions of exaggerated wealth, and encourages consumers to channel these frustrations into positive action. Through the campaign we aim to tell consumers that we understand them, and we offer a way for them to have greater control over their future.

Key Performance Metrics

Management monitors a number of customer activity and company metrics to evaluate the Company's performance. The most significant of these are displayed below along with the percentage variance for the three months ended June 30, 2017 from the same period in 2016, where applicable, and includes OptionsHouse from the September 12, 2016 acquisition date.

Customer Activity Metrics:



Table of Contents

E\*TRADE | Q2 2017 10-Q 4

---

Table of Contents

Daily Average Revenue Trades (DARTs) is the predominant driver of commissions revenue from our customers. DARTs were 208,205 and 207,717 for the three and six months ended June 30, 2017, respectively, compared to 152,488 and 158,653 for the same periods in 2016.

Derivative DARTs percentage is the mix of options and futures as a component of total DARTs and is a key driver of commissions revenue. Derivative DARTs represented 32% and 30% of total DARTs for the three and six months ended June 30, 2017, respectively, compared to 24% for the same periods in 2016.

Average commission per trade is an indicator of changes in our customer mix, product mix and/or product pricing. Average commission per trade was \$8.02 and \$8.93 for the three and six months ended June 30, 2017, respectively, compared to \$10.82 and \$10.73 for the same periods in 2016. Average commission per trade for the three and six months ended June 30, 2017 was impacted by our reduced commission rates for equity and options trades effective March 13, 2017.

Customer margin balances represents credit extended to customers to finance their purchases of securities by borrowing against securities they own and are a key driver of net interest income. Customer margin balances were \$8.2 billion and \$6.8 billion at June 30, 2017 and 2016, respectively. Customer margin includes OptionsHouse balances which are currently held by a third party clearing firm. Those balances were \$0.4 billion at June 30, 2017.

Managed products represents customer assets in our Managed Investment Portfolio, Unified Managed Account, Adaptive Portfolio, and Fixed Income Separately Managed Account products. Managed products are a driver of fees and service charges revenue. Managed products were \$4.6 billion and \$3.4 billion at June 30, 2017 and 2016, respectively.

## Table of Contents

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. End of period brokerage accounts were 3.6 million and 3.3 million at June 30, 2017 and 2016, respectively. Net new brokerage accounts were 41,271 and 99,486 for the three and six months ended June 30, 2017, respectively, and 23,090 and 63,549 for the same periods in 2016. Our annualized brokerage account attrition rate was 9.0% and 9.2% for the three and six months ended June 30, 2017, respectively, compared to 8.3% and 8.1% for the same periods in 2016. During the three and six months ended June 30, 2017, our annualized net new brokerage account growth rate was 4.7% and 5.7%, respectively, compared to 2.8% and 4.0% for the same periods in 2016. End of period brokerage accounts and net new brokerage accounts for the three months ended September 30, 2016 include 147,761 accounts from the OptionsHouse acquisition.

Customer assets is an indicator of the value of our relationship with the customer. An increase 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. Customer assets were \$348.2 billion and \$285.9 billion at June 30, 2017 and 2016, respectively.

Net new brokerage assets is total inflows to new and existing brokerage accounts less total outflows from closed and existing brokerage accounts. The net new brokerage assets metric is a general indicator of the use of our products and services by new and existing brokerage customers. Net new brokerage assets were \$2.6 billion and \$6.8 billion for the three and six months ended June 30, 2017, respectively, compared to \$1.6 billion and \$4.5 billion for the same periods in 2016. During the three and six months ended June 30, 2017, our annualized net new brokerage asset growth rate was 3.5% and 4.9%, respectively, compared to 2.6% and 3.7% for the same periods in 2016. Net new brokerage assets for the three months ended September 30, 2016 includes \$3.7 billion from the OptionsHouse acquisition.

Brokerage related cash is an indicator of the level of engagement with our brokerage customers and is a key driver of net interest income as well as fees and service charges revenue, which includes fees earned on customer cash held by third parties. Brokerage related cash was \$51.7 billion and \$43.0 billion at June 30, 2017 and 2016, respectively.

Company Metrics:

Table of Contents

E\*TRADE | Q2 2017 10-Q 7

---

## Table of Contents

Operating margin is the percentage of net revenue that results in income before income taxes and is an indicator of the Company's profitability. Operating margin was 55% and 48% for the three and six months ended June 30, 2017, respectively, compared to 45% and 43% for the same periods in 2016.

Adjusted operating margin is a non-GAAP measure that provides useful information about our ongoing operating performance by excluding the provision (benefit) for loan losses, which is not viewed as a key factor governing our investment in the business and is excluded by management when evaluating operating margin performance. Adjusted operating margin was 38% for both the three and six months ended June 30, 2017, respectively, compared to 38% and 36% for the same periods in 2016. See Earnings Overview for a reconciliation of this non-GAAP measure to the most directly comparable GAAP measure.

Corporate cash is a component of cash and equivalents and represents the primary source of capital above and beyond the capital deployed in our regulated subsidiaries. Corporate cash was \$478 million and \$523 million at June 30, 2017 and 2016, respectively. See Liquidity and Capital Resources for a reconciliation of this non-GAAP measure to the most directly comparable GAAP measure.

Tier 1 leverage ratio is an indicator of capital adequacy for E\*TRADE Financial and E\*TRADE Bank. Tier 1 leverage ratio is Tier 1 capital divided by adjusted average assets for leverage capital purposes. E\*TRADE Financial's Tier 1 leverage ratio was 7.5% at both June 30, 2017 and 2016. E\*TRADE Bank's Tier 1 leverage ratio was 8.0% and 8.2% at June 30, 2017 and 2016, respectively. See Liquidity and Capital Resources for additional information, including the calculation of regulatory capital ratios.

Allowance for loan losses is an estimate of probable losses inherent in the loan portfolio as of 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 (TDRs). Allowance for loan losses was \$116 million and \$293 million at June 30, 2017 and 2016, respectively.

Interest-earning assets, along with net interest margin, is an indicator of our ability to generate net interest income. Average interest-earning assets were \$51.9 billion and \$50.3 billion for the three and six months ended June 30, 2017, respectively, compared to \$43.4 billion and \$42.2 billion for the same periods in 2016.

Net interest margin is a measure of the net yield on our average interest-earning assets. Net interest margin is calculated for a given period by dividing the annualized sum of net interest income by average interest-earning assets. Net interest margin was 2.74% and 2.68% for the three and six months ended June 30, 2017, respectively, compared to 2.64% and 2.72% for the same periods in 2016.

Total employees were 3,614 and 3,588 at June 30, 2017 and 2016, respectively.

### Regulatory Developments

In April 2016, the U.S. Department of Labor published its final fiduciary regulations under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986. Certain aspects of these regulations began to take effect in June 2017. These regulations generally subject particular persons, such as broker-dealers and other financial advisers providing investment advice to individual retirement accounts and other qualified retirement plans and accounts, to fiduciary duties and additional regulatory restrictions for a wider range of customer interactions. The remaining aspects of these regulations are currently scheduled to take effect on January 1, 2018. During the transition period from June 2017 to January 2018, the Department of Labor indicated in Field Assistance Bulletin 2017-02 issued in May 2017 that it will not take enforcement actions against impacted parties that are in reasonable compliance with the regulations. The Company is in the process of implementing the remaining applicable regulations by the end date of the transition period.

The Company has historically not been subject to certain regulatory requirements that apply to banking organizations with \$50 billion or more in total consolidated assets as defined by each applicable regulation. Total consolidated assets of \$50 billion, which is measured in accordance with each applicable regulation, but generally on the basis of the average of the four most recent quarters, is a meaningful regulatory threshold as U.S. banking organizations become subject to a number of additional and, in some cases, more stringent



Table of Contents

regulatory requirements once they reach that size. The Company surpassed \$50 billion in total consolidated assets on a four quarter average in the first quarter of 2017.

The Company expects these regulatory requirements, not all of which have been finalized, to start becoming applicable to it in 2018. The Company has begun implementing policies, procedures, systems and governance structures that are designed to comply with the requirements. Additionally, while savings and loan holding companies are currently excluded from the scope of certain regulations that apply to bank holding companies, the Company expects it will ultimately be subject to these requirements. For additional information see Part I. Item 1. Business of our Annual Report on Form 10-K for the year ended December 31, 2016.

**EARNINGS OVERVIEW**

We generated net income of \$193 million and \$338 million on total net revenue of \$577 million and \$1.1 billion for the three and six months ended June 30, 2017, respectively. The following chart provides a reconciliation of net income for the three months ended June 30, 2016 to net income for the three months ended June 30, 2017 (dollars in millions):

Table of Contents

The significant components of the consolidated statement of income are as follows (dollars in millions except per share amounts):

	Three Months		Variance			Six Months		Variance		
	Ended June		2017 vs. 2016			Ended June		2017 vs. 2016		
	2017	2016	Amount	%		2017	2016	Amount	%	
Net interest income	\$356	\$286	\$70	24 %		\$675	\$573	\$102	18 %	
Total non-interest income	221	188	33	18 %		455	373	82	22 %	
Total net revenue	577	474	103	22 %		1,130	946	184	19 %	
Provision (benefit) for loan losses	(99 )	(35 )	(64 )	183 %		(113 )	(69 )	(44 )	64 %	
Total non-interest expense	359	295	64	22 %		701	607	94	15 %	
Income before income tax expense	317	214	103	48 %		542	408	134	33 %	
Income tax expense	124	81	43	53 %		204	122	82	67 %	
Net income	\$193	\$133	\$60	45 %		\$338	\$286	\$52	18 %	
Preferred stock dividends	—	—	—	— %		13	—	13	100 %	
Net income available to common shareholders	\$193	\$133	\$60	45 %		\$325	\$286	\$39	14 %	
Diluted earnings per common share	\$0.70	\$0.48	\$0.22	46 %		\$1.17	\$1.01	\$0.16	16 %	

Net income increased 45% to \$193 million and 18% to \$338 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. Net income available to common shareholders was \$193 million and \$325 million for the three and six months ended June 30, 2017, respectively, which reflects payment of a \$13 million preferred stock dividend in the first quarter of 2017, compared to \$133 million and \$286 million during the same periods in 2016. We recognized a benefit for loan losses of \$99 million and \$113 million for the three and six months ended June 30, 2017, respectively, compared to \$35 million and \$69 million for the same periods in 2016. Net income for the three and six months ended June 30, 2017 also included \$9 million and \$15 million, respectively, of pre-tax costs primarily incurred in connection with the OptionsHouse integration and preparation for the incremental regulatory and reporting requirements that our balance sheet growth requires. Higher advertising and market development expenses driven by our new advertising campaign, as well as increased communications expense, also impacted current quarter results. Net income for the six months ended June 30, 2016 included an income tax benefit related to the release of a valuation allowance against certain state deferred tax assets.



Table of Contents

## Net Revenue

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

	Three Months Ended June 30,		Variance 2017 vs. 2016			Six Months Ended June 30,		Variance 2017 vs. 2016	
	2017	2016	Amount	%		2017	2016	Amount	%
Net interest income	\$356	\$286	\$70	24 %		\$675	\$573	\$102	18 %
Commissions	105	106	(1)	(1) %		232	213	19	9 %
Fees and service charges	98	62	36	58 %		184	120	64	53 %
Gains on securities and other, net	7	10	(3)	(30) %		17	20	(3)	(15) %
Other revenue	11	10	1	10 %		22	20	2	10 %
Total non-interest income	221	188	33	18 %		455	373	82	22 %
Total net revenue	\$577	\$474	\$103	22 %		\$1,130	\$946	\$184	19 %

## Net Interest Income

Net interest income increased 24% to \$356 million and 18% to \$675 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. Net interest income is earned primarily through investment securities, margin receivables and our legacy loan portfolio, offset by funding costs.

Table of Contents

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

	Three Months Ended June 30,					
	2017			2016		
	Average Balance	Interest Inc./Exp.	Average Yield/Cost	Average Balance	Interest Inc./Exp.	Average Yield/Cost
Cash and equivalents	\$890	\$ 2	0.87 %	\$1,589	\$ 1	0.36 %
Cash required to be segregated under federal or other regulations	1,355	3	0.94 %	1,599	1	0.34 %
Available-for-sale securities	18,197	95	2.10 %	13,503	68	2.01 %
Held-to-maturity securities	19,725	137	2.78 %	15,354	107	2.80 %
Margin receivables	7,258	75	4.14 %	6,502	61	3.76 %
Loans <sup>(1)</sup>	3,332	41	4.88 %	4,512	49	4.32 %
Broker-related receivables and other	1,142	1	0.20 %	363	1	0.29 %
Subtotal interest-earning assets	51,899	354	2.73 %	43,422	288	2.65 %
Other interest revenue <sup>(2)</sup>	—	24		—	18	
Total interest-earning assets	51,899	378	2.91 %	43,422	306	2.83 %
Total non-interest-earning assets <sup>(3)</sup>	4,951			4,815		
Total assets	\$56,850			\$48,237		
Deposits	\$37,894	\$ 1	0.01 %	\$31,865	\$ 1	0.01 %
Customer payables	8,686	2	0.06 %	6,913	1	0.07 %
Broker-related payables and other	1,237	—	0.00 %	1,345	—	0.00 %
Other borrowings	674	5	3.18 %	410	4	4.43 %
Corporate debt	991	13	5.41 %	993	14	5.40 %
Subtotal interest-bearing liabilities	49,482	21	0.17 %	41,526	20	0.19 %
Other interest expense <sup>(4)</sup>	—	1		—	—	
Total interest-bearing liabilities	49,482	22	0.18 %	41,526	20	0.20 %
Total non-interest-bearing liabilities <sup>(5)</sup>	884			969		
Total liabilities	50,366			42,495		
Total shareholders' equity	6,484			5,742		
Total liabilities and shareholders' equity	\$56,850			\$48,237		
Excess interest earning assets over interest bearing liabilities/net interest income/net interest margin	\$2,417	\$ 356	2.74 %	\$1,896	\$ 286	2.64 %

Nonaccrual loans are included in the average loan balances. Interest payments received on nonaccrual loans are (1) recognized on a cash basis in interest income until it is doubtful that full payment will be collected, at which point payments are applied to principal.

(2) Represents interest income on securities loaned.

(3) Non-interest earning assets consist of property and equipment, net, goodwill, other intangibles, net and other assets that do not generate interest income.

(4) Represents interest expense on securities borrowed.

(5) Non-interest bearing liabilities consist of other liabilities that do not generate interest expense.



Table of Contents

	Six Months Ended June 30, 2017			2016		
	Average Balance	Interest Inc./Exp.	Average Yield/ Cost	Average Balance	Interest Inc./Exp.	Average Yield/ Cost
Cash and equivalents	\$1,116	\$ 4	0.73 %	\$1,600	\$ 3	0.38 %
Cash required to be segregated under federal or other regulations	1,519	6	0.81 %	1,366	2	0.33 %
Available-for-sale securities	17,396	180	2.08 %	13,072	132	2.02 %
Held-to-maturity securities	18,634	257	2.76 %	14,515	210	2.90 %
Margin receivables	7,021	141	4.04 %	6,590	125	3.82 %
Loans <sup>(1)</sup>	3,469	84	4.82 %	4,658	100	4.28 %
Broker-related receivables and other	1,131	1	0.16 %	356	1	0.29 %
Subtotal interest-earning assets	50,286	673	2.68 %	42,157	573	2.72 %
Other interest revenue <sup>(2)</sup>	—	46		—	41	
Total interest-earning assets	50,286	719	2.87 %	42,157	614	2.92 %
Total non-interest-earning assets <sup>(3)</sup>	5,100			4,868		
Total assets	\$55,386			\$47,025		
Deposits	\$36,390	\$ 2	0.01 %	\$30,716	\$ 2	0.01 %
Customer payables	8,686	3	0.06 %	6,682	2	0.07 %
Broker-related payables and other	1,199	—	0.00 %	1,398	—	0.00 %
Other borrowings	584	10	3.46 %	423	9	4.28 %
Corporate debt	992	27	5.40 %	994	27	5.39 %
Subtotal interest-bearing liabilities	47,851	42	0.17 %	40,213	40	0.20 %
Other interest expense <sup>(4)</sup>	—	2		—	1	
Total interest-bearing liabilities	47,851	44	0.18 %	40,213	41	0.21 %
Total non-interest-bearing liabilities <sup>(5)</sup>	1,142			1,079		
Total liabilities	48,993			41,292		
Total shareholders' equity	6,393			5,733		
Total liabilities and shareholders' equity	\$55,386			\$47,025		
Excess interest earning assets over interest bearing liabilities/net interest income/net interest margin	\$2,435	\$ 675	2.68 %	\$1,944	\$ 573	2.72 %

Nonaccrual loans are included in the average loan balances. Interest payments received on nonaccrual loans are (1) recognized on a cash basis in interest income until it is doubtful that full payment will be collected, at which point payments are applied to principal.

(2) Represents interest income on securities loaned.

(3) Non-interest earning assets consist of property and equipment, net, goodwill, other intangibles, net and other assets that do not generate interest income.

(4) Represents interest expense on securities borrowed.

(5) Non-interest bearing liabilities consist of other liabilities that do not generate interest expense.

Average interest-earning assets increased 20% to \$51.9 billion and 19% to \$50.3 billion for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The fluctuation in interest-earning assets is generally driven by changes in interest-bearing liabilities, primarily deposits and customer payables. Average interest-bearing liabilities increased 19% to \$49.5 billion and 19% to \$47.9 billion for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The increase was primarily due to higher deposits as a result of transferring customer cash held by third parties to our balance sheet. For additional information on our balance sheet growth and customer cash held by third parties, see Balance Sheet Overview.

Net interest margin increased 10 basis points to 2.74% and decreased 4 basis points to 2.68% for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. Net interest margin is driven by the mix of asset and liability average balances and the interest rates earned or paid on those balances. The increase during the three months ended June 30, 2017, compared to the same period in 2016, is due to higher interest rates earned on increased margin receivable balances and higher

Table of Contents

securities lending activities, partially offset by the continued run-off of our higher yielding legacy loan portfolio. The decline during the six months ended June 30, 2017, compared to the same period in 2016, is due to an increase in the overall allocation of lower yielding securities purchased with customer cash transferred to our balance sheet and proceeds from principal payments received on our higher yielding legacy loan portfolio that continues to become a smaller percentage of our interest-earning assets, partially offset by higher interest rates earned on increased average margin balances.

**Commissions**

Commissions revenue decreased 1% to \$105 million and increased 9% to \$232 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The main factors that affect commissions revenue are DARTs, average commission per trade and the number of trading days. DARTs volume increased 37% to 208,205 and 31% to 207,717 for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016, mainly driven by the inclusion of OptionsHouse accounts and the strength of the equity markets. Derivative DARTs represented 32% and 30% of trading volume for the three and six months ended June 30, 2017, respectively, compared to 24% of trading volume for both periods in 2016. Average commission per trade decreased 26% to \$8.02 and 17% to \$8.93 for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. Average commission per trade is impacted by customer mix and differing commission rates on various trade types (e.g. equities, derivatives, stock plan and mutual funds). Average commission per trade for the three and six months ended June 30, 2017 was impacted by reduced commission rates implemented in March 2017 as well as our lower price structure for OptionsHouse customers.

**Fees and Service Charges**

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

	Three Months Ended June 30, 2017		Variance 2017 vs. 2016		Six Months Ended June 30, 2017		Variance 2017 vs. 2016	
	2017	2016	Amount	%	2017	2016	Amount	%
Order flow revenue	\$34	\$22	\$12	55 %	\$65	\$44	\$21	48 %
Money market funds and sweep deposits revenue <sup>(1)</sup>	26	10	16	160 %	48	18	30	167 %
Mutual fund service fees	10	9	1	11 %	19	18	1	6 %
Advisor management fees	9	6	3	50 %	17	13	4	31 %
Foreign exchange revenue	6	5	1	20 %	14	9	5	56 %
Reorganization fees	5	4	1	25 %	8	7	1	14 %
Other fees and service charges	8	6	2	33 %	13	11	2	18 %
Total fees and service charges	\$98	\$62	\$36	58 %	\$184	\$120	\$64	53 %

<sup>(1)</sup> Includes revenue earned on average customer cash held by third parties based on the federal funds rate or LIBOR plus a negotiated spread or other contractual arrangements with the third party institutions.

Fees and service charges increased 58% to \$98 million and 53% to \$184 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The increase in fees and service charges was primarily driven by the impact of a higher interest rate environment and higher average balances of customer cash held by third parties. The gross yield on customer cash held by third parties for the three and six months ended June 30, 2017 of approximately 90 and 70 basis points compares to approximately 40 and 35 basis points for the same periods in 2016. In addition, fees and service charges benefited from increased order flow revenue resulting primarily from higher options trading activity and improved rates.

Table of Contents

## Gains on Securities and Other, Net

The components of gains on securities and other, net and the resulting variances are as follows (dollars in millions):

	Three Months Ended June 30, 2017			Variance 2017 vs. 2016	Six Months Ended June 30, 2017			Variance 2017 vs. 2016
	2017	2016	Amount	%	2017	2016	Amount	%
Gains on available-for-sale securities	\$10	\$14	\$ (4)	(29)%	\$18	\$29	\$ (11)	(38)%
Hedge ineffectiveness	(2)	(2)	—	—%	(3)	(4)	1	(25)%
Equity method investment income (loss) and other	(1)	(2)	1	(50)%	2	(5)	7	(140)%
Gains on securities and other, net	\$7	\$10	\$ (3)	(30)%	\$17	\$20	\$ (3)	(15)%

## Provision (Benefit) for Loan Losses

We recognized a benefit for loan losses of \$99 million and \$113 million for the three and six months ended June 30, 2017, respectively, compared to a benefit of \$35 million and \$69 million for the same periods in 2016. The timing and magnitude of the provision (benefit) for loan losses is affected by many factors that could result in variability. The current period reflected approximately \$70 million of benefit resulting from refined default assumptions based on the sustained outperformance of converted mortgage loans that had been amortizing for 12 months or longer. The current period benefit also reflected recoveries in excess of prior estimates, including recoveries of previous charge-offs. For additional information on management's estimate of the allowance for loan losses, see Concentrations of Credit Risk and Summary of Critical Accounting Policies and Estimates.

## Non-Interest Expense

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

	Three Months Ended June 30, 2017			Variance 2017 vs. 2016	Six Months Ended June 30, 2017			Variance 2017 vs. 2016
	2017	2016	Amount	%	2017	2016	Amount	%
Compensation and benefits	\$133	\$125	\$8	6%	\$269	\$251	\$18	7%
Advertising and market development	42	30	12	40%	85	73	12	16%
Clearing and servicing	33	25	8	32%	65	49	16	33%
Professional services	24	22	2	9%	46	44	2	5%
Occupancy and equipment	29	24	5	21%	56	47	9	19%
Communications	36	20	16	80%	61	43	18	42%
Depreciation and amortization	20	20	—	—%	40	40	—	—%
FDIC insurance premiums	8	6	2	33%	16	12	4	33%
Amortization of other intangibles	9	5	4	80%	18	10	8	80%
Restructuring and acquisition-related activities	4	1	3	300%	8	3	5	167%
Other non-interest expenses	21	17	4	24%	37	35	2	6%
Total non-interest expense	\$359	\$295	\$64	22%	\$701	\$607	\$94	15%

Table of Contents

Compensation and Benefits

Compensation and benefits expense increased 6% to \$133 million and 7% to \$269 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The increase was primarily driven by the increase in employee headcount during the three and six months ended June 30, 2017 resulting from our acquisition of OptionsHouse.

Advertising and Market Development

Advertising and market development expense increased 40% to \$42 million and 16% to \$85 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The increase was primarily due to higher spending as we launched our new advertising campaign during the three months ended June 30, 2017.

Clearing and Servicing

Clearing and servicing expense increased 32% to \$33 million and 33% to \$65 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The increase was primarily related to higher trading volume compared to the same periods in 2016.

Occupancy and Equipment

Occupancy and equipment expense increased 21% to \$29 million and 19% to \$56 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The increase was primarily driven by higher information technology expenses associated with the Company's balance sheet growth and information security initiatives, compared to the same periods in 2016.

Communications

Communications expense increased 80% to \$36 million and 42% to \$61 million for the three and six months ended June 30, 2017, respectively, compared to the same periods in 2016. The increase was primarily driven by increased market data fees. During the three months ended June 30, 2017, we made significant progress in gathering customer data used to identify the population of professional users of real time market data. As the exchanges assess higher rates for these users, we updated our accrual estimate and recognized \$9 million related to previous usage.

Operating Margin

Operating margin was 55% and 48% for the three and six months ended June 30, 2017, respectively, compared to 45% and 43% for the same periods in 2016. Adjusted operating margin, a non-GAAP measure, was 38% for both the three and six months ended June 30, 2017, respectively, compared to 38% and 36% for the same periods in 2016.



Table of Contents

Adjusted operating margin is a non-GAAP measure calculated by dividing adjusted income before income tax expense by total net revenue. Adjusted income before income tax expense excludes the provision (benefit) for loan losses. The following table provides a reconciliation of adjusted income before income tax expense and adjusted operating margin, non-GAAP measures, to the most directly comparable GAAP measures (dollars in millions):

	Three Months Ended June 30, 2017		2016		Six Months Ended June 30, 2017		2016	
	Amount	Operating Margin %	Amount	Operating Margin %	Amount	Operating Margin %	Amount	Operating Margin %
Income before income tax expense / operating margin	\$317	55%	\$214	45%	\$542	48%	\$408	43%
Provision (benefit) for loan losses	(99 )		(35 )		(113 )		(69 )	
Adjusted income before income tax expense / adjusted operating margin	\$218	38%	\$179	38%	\$429	38%	\$339	36%
Income Tax Expense								

Income tax expense was \$124 million and \$204 million for the three and six months ended June 30, 2017, respectively, compared to \$81 million and \$122 million for the same periods in 2016. The effective tax rates were 39% and 38% for the three and six months ended June 30, 2017, respectively, compared to 38% and 30% for the same periods in 2016.

The effective tax rate of 38% for the six months ended June 30, 2017 includes a tax benefit related to the adoption of amended accounting guidance for employee share-based compensation. See Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies for additional information. The effective tax rate of 30% for the six months ended June 30, 2016 was impacted by a tax benefit related to the release of valuation allowances against certain state deferred tax assets.

Table of Contents

## BALANCE SHEET OVERVIEW

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

			Variance	
	June 30,	December	2017 vs. 2016	
	2017	31,	Amount	%
		2016		
Assets:				
Cash and equivalents	\$1,091	\$ 1,950	\$(859 )	(44 )%
Segregated cash	889	1,460	(571 )	(39 )%
Securities <sup>(1)</sup>	40,392	29,643	10,749	36 %
Margin receivables	7,773	6,731	1,042	15 %
Loans receivable, net	3,055	3,551	(496 )	(14 )%
Receivables from brokers, dealers and clearing organizations <sup>(2)</sup>	1,237	1,056	181	17 %
Goodwill and other intangibles, net	2,673	2,690	(17 )	(1 )%
Deferred tax assets, net	519	756	(237 )	(31 )%
Other <sup>(3)</sup>	1,124	1,162	(38 )	(3 )%
Total assets	\$58,753	\$ 48,999	\$9,754	20 %
Liabilities and shareholders' equity:				
Deposits	\$40,072	\$ 31,682	\$8,390	26 %
Customer payables	7,992	8,159	(167 )	(2 )%
Payables to brokers, dealers and clearing organizations <sup>(4)</sup>	1,473	983	490	50 %
Other borrowings	1,009	409	600	147 %
Corporate debt	992	994	(2 )	— %
Other liabilities	532	500	32	6 %
Total liabilities	52,070	42,727	9,343	22 %
Shareholders' equity	6,683	6,272	411	7 %
Total liabilities and shareholders' equity	\$58,753	\$ 48,999	\$9,754	20 %

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

(2) Includes deposits paid for securities borrowed of \$668 million and \$774 million as of June 30, 2017 and December 31, 2016, respectively.

(3) Includes balance sheet line items property and equipment, net and other assets.

(4) Includes deposits received for securities loaned of \$1.4 billion and \$926 million as of June 30, 2017 and December 31, 2016, respectively.

## Cash and Equivalents

Cash and equivalents decreased 44% to \$1.1 billion during the six months ended June 30, 2017 and includes corporate cash of \$478 million as of June 30, 2017. Cash and equivalents will fluctuate based on a variety of factors, including, among other drivers, liquidity needs at the parent, customer activity at our regulated subsidiaries, and the timing of investments at E\*TRADE Bank. For additional information on our use of cash and equivalents, including corporate cash, see Liquidity and Capital Resources.

## Segregated Cash

Cash required to be segregated under federal or other regulations decreased 39% to \$889 million during the six months ended June 30, 2017. The level of segregated cash is driven largely by customer payables and securities lending balances we hold as liabilities compared with the amount of margin receivables and securities borrowed balances we hold as assets. The excess represents customer cash that we are required by our regulators to segregate for the exclusive benefit of our brokerage customers. At June 30, 2017 and December 31, 2016, \$850 million and \$500 million, respectively, of reverse repurchase agreements between E\*TRADE Securities and E\*TRADE Bank, representing investments that are required

E\*TRADE | Q2 2017 10-Q 18

---

Table of Contents

to be segregated under federal or other regulations by E\*TRADE Securities, were eliminated in consolidation. Securities

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

	June 30,	December	Variance	
	2017	31, 2016	2017 vs. 2016	
			Amount	%
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$ 17,380	\$ 12,634	\$ 4,746	38 %
Other debt securities	1,503	1,251	252	20 %
Total debt securities	18,883	13,885	4,998	36 %
Publicly traded equity securities <sup>(1)</sup>	7	7	—	— %
Total available-for-sale securities	\$ 18,890	\$ 13,892	\$ 4,998	36 %
Held-to-maturity securities:				
Agency mortgage-backed securities	\$ 18,426	\$ 12,868	\$ 5,558	43 %
Other debt securities	3,076	2,883	193	7 %
Total held-to-maturity securities	\$ 21,502	\$ 15,751	\$ 5,751	37 %
Total investments in securities	\$ 40,392	\$ 29,643	\$ 10,749	36 %

(1) Consists of Community Reinvestment Act investments in a mutual fund.

Securities represented 69% and 60% of total assets at June 30, 2017 and December 31, 2016, respectively. We classify debt securities as available-for-sale or held-to-maturity based on our investment strategy and management's assessment of our intent and ability to hold the debt securities until maturity.

The increase in total investments in securities during the six months ended June 30, 2017 was primarily due to net purchases of investment securities as a result of our efforts to grow the balance sheet by transferring customer cash held by third parties to our balance sheet.

#### Margin Receivables

Margin receivables increased 15% to \$7.8 billion during the six months ended June 30, 2017. The increase in margin receivables was primarily driven by improved market sentiment increasing demand for additional margin lending.

#### Loans Receivable, Net

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

	June 30, 2017	December 31, 2016	Variance 2017 vs. 2016	
			Amount	%
One- to four-family	\$1,659	\$1,950	\$(291)	(15)%
Home equity	1,287	1,556	(269)	(17)%
Consumer	212	250	(38)	(15)%
Total loans receivable	3,158	3,756	(598)	(16)%
Unamortized premiums, net	13	16	(3)	(19)%
Allowance for loan losses	(116)	(221)	105	(48)%
Total loans receivable, net	\$3,055	\$3,551	\$(496)	(14)%

Loans receivable, net decreased 14% to \$3.1 billion during the six months ended June 30, 2017. During the three months ended June 30, 2017 the Company sold certain loans with a carrying value of \$41 million for



Table of Contents

proceeds that approximated book value. We expect the remaining legacy loan portfolio to continue its run-off for the foreseeable future. As our portfolio has seasoned and substantially all interest-only loans have converted to amortizing, we continue to assess underlying performance, the economic environment, and the value of the portfolio in the marketplace. While it is our intention to hold these loans, if the markets improve our strategy could change. For additional information on management's estimate of the allowance for loan losses, see Concentrations of Credit Risk and Summary of Critical Accounting Policies and Estimates.

**Deposits**

Deposits are summarized as follows (dollars in millions):

			Variance	
	June 30,	December	2017 vs. 2016	
	2017	31, 2016	Amount	%
Sweep deposits	\$34,937	\$26,362	\$8,575	33 %
Savings deposits	3,078	3,185	(107 )	(3 )%
Other deposits	2,057	2,135	(78 )	(4 )%
Total deposits	\$40,072	\$31,682	\$8,390	26 %

Deposits represented 77% and 74% of total liabilities at June 30, 2017 and December 31, 2016, respectively. At June 30, 2017, approximately 92% of our customer deposits were covered by FDIC insurance. Deposits increased \$8.4 billion during the six months ended June 30, 2017 primarily as a result of transferring customer cash held by third parties to our balance sheet.

The majority of the deposits balance, specifically sweep deposits, is included in brokerage related cash, which is reported as a customer activity metric. Total brokerage related cash is summarized as follows (dollars in millions):

			Variance	
	June 30,	December	2017 vs. 2016	
	2017	31, 2016	Amount	%
Sweep deposits <sup>(1)</sup>	\$34,937	\$26,362	\$8,575	33 %
Customer payables	7,992	8,159	(167 )	(2 )%
Subtotal	42,929	34,521	8,408	24 %
Customer cash held by third parties <sup>(2)</sup>	8,814	16,848	(8,034 )	(48)%
Total brokerage related cash	\$51,743	\$51,369	\$374	1 %

(1) Sweep deposits are held at bank subsidiaries and are included in the deposits line item on our consolidated balance sheet.

(2) Customer cash held by third parties is not reflected on our consolidated balance sheet and is not immediately available for liquidity purposes.

We offer an extended insurance sweep deposit account (ESDA) program to our brokerage customers. The ESDA program utilizes our bank subsidiaries, in combination with additional third party program banks, to allow customers the ability to have aggregate deposits they hold in the ESDA program insured up to \$1,250,000 for each category of legal ownership. As of June 30, 2017, approximately 99% of sweep deposits were in the ESDA program.

Table of Contents

Customer cash held by third parties is maintained at unaffiliated financial institutions and a third party clearing firm. The components of customer cash held by third parties are summarized as follows (dollars in millions):

	June 30, 2017	December 31, 2016	Variance 2017 vs. 2016	
			Amount	%
Sweep deposits held by unaffiliated financial institutions	\$6,602	\$ 14,943	\$(8,341)	(56)%
Customer cash held by third party clearing firm <sup>(1)</sup>	1,655	1,634	21	1%
Municipal funds and other	557	271	286	106%
Customer cash held by third parties	\$8,814	\$ 16,848	\$(8,034)	(48)%

(1) Represents OptionsHouse customer cash held by third party.

As of June 30, 2017, approximately \$5 billion of customer cash held by third parties was available for balance sheet growth. The timing of our balance sheet growth will be impacted by a variety of factors, including the capital requirements applicable to both the Company and E\*TRADE Bank.

**Other Borrowings**

Other borrowings are summarized as follows (dollars in millions):

	June 30, 2017	December 31, 2016	Variance 2017 vs. 2016	
			Amount	%
Repurchase agreements	\$400	\$ —	\$400	100%
FHLB advances	200	—	200	100%
Total repurchase agreements and FHLB advances	600	—	600	100%
Trust preferred securities	409	409	—	—%
Total other borrowings	\$1,009	\$ 409	\$600	147%

Other borrowings increased 147% to \$1.0 billion during the six months ended June 30, 2017 as we utilized repurchase agreements and Federal Home Loan Bank (FHLB) advances for short-term liquidity and funding requirements. See Liquidity and Capital Resources for additional information on liquidity and funding sources at E\*TRADE Bank.

**LIQUIDITY AND CAPITAL RESOURCES**

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

**Liquidity**

Our corporate liquidity needs are primarily driven by capital needs at E\*TRADE Bank and E\*TRADE Securities as well as by the principal and interest due on our corporate debt and the amount of dividend payments on our preferred stock. Our banking and brokerage subsidiaries' liquidity needs are driven primarily by the level and volatility of our customer activity. Management maintains a set of liquidity sources and monitors certain business trends and market metrics closely in an effort to ensure we have sufficient liquidity. Potential loans by E\*TRADE Bank to the parent company and its other non-bank subsidiaries are subject to various quantitative, arm's length, collateralization, capital and other requirements.

Table of Contents

Parent Company Liquidity

The parent company's primary source of liquidity is corporate cash. Corporate cash, a non-GAAP measure, is a component of cash and equivalents; see the consolidated statement of cash flows within Item 1. Condensed Consolidated Financial Statements (Unaudited) for information on cash and equivalents activity. We define corporate cash as cash held at the parent company and certain subsidiaries, not including bank and broker-dealer subsidiaries, that can be distributed to the parent company without any regulatory approval or notification. E\*TRADE Bank and its subsidiaries require regulatory approval prior to the payment of certain dividends to the parent company. Our broker-dealer subsidiaries can pay dividends to the parent company with proper regulatory notifications.

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 the following:

• Dividends from subsidiaries

• Non-cumulative preferred stock dividends

• Share repurchases

• Debt service costs

• Acquisitions and investments

• Tax payments and the reimbursement from the parent company's subsidiaries for the use of its deferred tax assets

• Other overhead and expense reimbursements through cost sharing arrangements



Table of Contents

The following chart provides a roll forward of corporate cash at December 31, 2016 to corporate cash at June 30, 2017 (dollars in millions):

(1) Other activity includes contributions to subsidiaries and parent company overhead, offset by reimbursements from subsidiaries for use of the parent's deferred tax assets and related proceeds under overhead cost sharing arrangements. The following table provides a reconciliation of consolidated cash and equivalents to corporate cash, a non-GAAP measure (dollars in millions):

	June 30, 2017	December 31, 2016	June 30, 2016
Consolidated cash and equivalents	\$1,091	\$1,950	\$2,393
Less: Cash at regulated subsidiaries <sup>(1)</sup>	(613 )	(1,489 )	(1,870 )
Corporate cash	\$478	\$461	\$523

(1) Reported net of corporate cash on deposit at E\*TRADE Bank that is eliminated in consolidation.

Corporate cash increased \$17 million to \$478 million during the six months ended June 30, 2017. Corporate cash included dividends of \$120 million from E\*TRADE Securities to the parent company during the six months ended June 30, 2017. Corporate cash also included the impact of preferred stock dividends, debt service, overhead cost sharing arrangements between the parent and our operating subsidiaries, and the impact of annual incentive compensation payments in the six months ended June 30, 2017.

We maintain corporate cash at a minimum of two times our scheduled annual corporate debt service payments and scheduled maturities over the next 12 months. As we do not have any scheduled maturities of corporate debt in the coming year, our current minimum is approximately \$100 million. Our nearest maturity of interest-bearing corporate debt is November 2022.

On June 23, 2017, we entered into an unsecured committed revolving credit facility with certain lenders, which replaced our previous secured committed revolving credit facility entered into in November 2014 and

## Table of Contents

increased our total borrowing capacity under the facility to \$300 million. The Company has the ability to borrow against the credit facility for working capital and general corporate purposes. The unsecured committed revolving credit facility will mature on June 23, 2020. At June 30, 2017, there was no outstanding balance under this revolving credit facility.

### **E\*TRADE Bank Liquidity**

E\*TRADE Bank relies on bank cash and deposits for liquidity needs. Management believes that within deposits, sweep deposits are of particular importance as they are a stable source of liquidity for E\*TRADE Bank. We have the ability to generate liquidity in the form of additional deposits by raising the yield on our customer deposit products and by bringing additional deposits onto our balance sheet. Sweep deposits on our balance sheet as of June 30, 2017 increased \$8.6 billion compared to December 31, 2016. We utilize our sweep deposit platform to efficiently manage our balance sheet size.

We may utilize wholesale funding sources for short-term liquidity and contingency funding requirements. 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 of Richmond's discount window to meet short-term liquidity requirements, although it is not viewed as a primary source of funding. At June 30, 2017, E\*TRADE Bank had approximately \$4.8 billion and \$0.6 billion in additional collateralized borrowing capacity with the FHLB and the Federal Reserve Bank of Richmond, respectively.

### **E\*TRADE Securities Liquidity**

E\*TRADE Securities relies on customer payables, securities lending, and internal and external lines of credit to provide liquidity and to fund margin lending. At June 30, 2017, E\*TRADE Securities' external liquidity lines totaled approximately \$1.1 billion and included the following:

- A 364-day, \$450 million senior unsecured committed revolving credit facility with a syndicate of banks, with a maturity date of June 2018 and a commitment fee of 0.35% on unused balances
- Secured committed lines of credit with two unaffiliated banks, aggregating to \$175 million, with a maturity date of June 2018 and a commitment fee of 0.15% on unused balances
- Unsecured uncommitted lines of credit with two unaffiliated banks, aggregating to \$75 million, of which \$50 million matures in June 2018 and the remaining line has no maturity date
- Secured uncommitted lines of credit with several unaffiliated banks, aggregating to \$375 million with no maturity date

The revolving credit facility contains certain covenants, including maintenance covenants related to E\*TRADE Securities' minimum consolidated tangible net worth and regulatory net capital ratio. There were no outstanding balances for any of these lines at June 30, 2017. E\*TRADE Securities also maintains lines of credit with the parent company and E\*TRADE Bank.

### **Liquidity Coverage Ratio**

As a result of the Company's balance sheet growth, we will be subject to the modified liquidity coverage ratio (LCR) requirement beginning April 1, 2018. The purpose of the LCR is to require banking organizations to hold minimum amounts of high-quality liquid assets (HQLA) based on a percentage of their net cash outflows over a 30-day period. Bank and savings and loan holding companies with total consolidated assets of \$50 billion or more, based on the average of the four most recent quarters, are subject to a modified LCR requiring them to hold HQLA in an amount equal to at least 70% of their projected net cash outflows over a 30-day period. The Company believes the LCR is an important measure of liquidity and has been managing against it in preparation for the applicability of these requirements. In addition, beginning October 1, 2018, we will be required to disclose certain quantitative and qualitative information related to our LCR calculation after each calendar quarter.

Table of Contents

Capital Resources

Bank Capital Requirements

The Dodd-Frank Act requires all companies, including savings and loan holding companies, that directly or indirectly control an insured depository institution, to serve as a source of strength for the institution. The Company and E\*TRADE Bank are subject to regulatory capital requirements. Some of these requirements are still subject to phase-in periods, including certain deductions from and adjustments to regulatory capital that will be fully implemented at 100% in 2018. For additional information on bank regulatory requirements and phase-in periods, see Part I. Item 1. Business—Regulation in our Annual Report on Form 10-K for the year ended December 31, 2016. At June 30, 2017, our regulatory capital ratios for E\*TRADE Financial were well above the minimum ratios required to be "well capitalized." E\*TRADE Financial's current Tier 1 Leverage ratio threshold of 6.5% was reduced from 7.0% in July 2017. E\*TRADE Financial's capital ratios are as follows:

Table of Contents

E\*TRADE Financial's capital ratios are calculated as follows (dollars in millions):

	June 30, 2017	December 31, 2016	June 30, 2016	
E*TRADE Financial shareholders' equity	\$6,683	\$6,272	\$5,785	
Deduct:				
Preferred stock	(394 )	(394 )	—	
E*TRADE Financial Common Equity Tier 1 capital before regulatory adjustments	\$6,289	\$5,878	\$5,785	
Add:				
(Gains) losses in other comprehensive income on available-for-sale debt securities, net of tax	62	139	(43 )	
Deduct:				
Goodwill and other intangible assets, net of deferred tax liabilities	(2,039 )	(2,029 )	(1,422 )	
Disallowed deferred tax assets	(537 )	(505 )	(857 )	
E*TRADE Financial Common Equity Tier 1 capital	3,775	3,483	3,463	
Add:				
Preferred stock	394	394	—	
Deduct:				
Disallowed deferred tax assets	(124 )	(267 )	—	
E*TRADE Financial Tier 1 capital	\$4,045	\$3,610	\$3,463	
Add:				
Allowable allowance for loan losses	116	124	129	
Non-qualifying capital instruments subject to phase-out (trust preferred securities)	414	414	414	
E*TRADE Financial total capital	\$4,575	\$4,148	\$4,006	
E*TRADE Financial average assets for leverage capital purposes	\$56,928	\$49,113	\$48,255	
Deduct:				
Goodwill and other intangible assets, net of deferred tax liabilities	(2,039 )	(2,029 )	(1,422 )	
Disallowed deferred tax assets	(661 )	(772 )	(857 )	
E*TRADE Financial adjusted average assets for leverage capital purposes	\$54,228	\$46,312	\$45,976	
E*TRADE Financial total risk-weighted assets <sup>(1)</sup>	\$10,780	\$9,422	\$9,731	
E*TRADE Financial Tier 1 leverage ratio (Tier 1 capital / Adjusted average assets for leverage capital purposes)	7.5	% 7.8	% 7.5	%
E*TRADE Financial Common Equity Tier 1 capital / Total risk-weighted assets	35.0	% 37.0	% 35.6	%
E*TRADE Financial Tier 1 capital / Total risk-weighted assets	37.5	% 38.3	% 35.6	%
E*TRADE Financial total capital / Total risk-weighted assets	42.4	% 44.0	% 41.2	%

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 (1)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.

Table of Contents

At June 30, 2017, our regulatory capital ratios for E\*TRADE Bank were well above the minimum ratios required to be "well capitalized." E\*TRADE Bank's current Tier 1 Leverage ratio threshold is 7.5%. We plan to use excess capital at E\*TRADE Bank to grow the balance sheet. Accordingly, we do not expect to distribute dividends from E\*TRADE Bank to the parent while we fund that growth. E\*TRADE Bank's capital ratios are as follows:

E\*TRADE | Q2 2017 10-Q 27

---

Table of Contents

E\*TRADE Bank's capital ratios are calculated as follows (dollars in millions):

	June 30, 2017	December 31, 2016	June 30, 2016	
E*TRADE Bank shareholder's equity	\$3,485	\$3,153	\$3,207	
Add:				
(Gains) losses in other comprehensive income on available-for-sale debt securities, net of tax	62	139	(43)	)
Deduct:				
Goodwill and other intangible assets, net of deferred tax liabilities	(38)	(38)	(38)	)
Disallowed deferred tax assets	(56)	(122)	(186)	)
E*TRADE Bank Common Equity Tier 1 capital / Tier 1 capital	3,453	3,132	2,940	
Add:				
Allowable allowance for loan losses	116	105	112	
E*TRADE Bank total capital	\$3,569	\$3,237	\$3,052	
E*TRADE Bank average assets for leverage capital purposes	\$43,527	\$35,885	\$36,292	
Deduct:				
Goodwill and other intangible assets, net of deferred tax liabilities	(38)	(38)	(38)	)
Disallowed deferred tax assets	(56)	(122)	(186)	)
E*TRADE Bank adjusted average assets for leverage capital purposes	\$43,433	\$35,725	\$36,068	
E*TRADE Bank total risk-weighted assets <sup>(1)</sup>	\$9,840	\$8,187	\$8,594	
E*TRADE Bank Tier 1 leverage ratio (Tier 1 capital / Adjusted average assets for leverage capital purposes)	8.0	% 8.8	% 8.2	%
E*TRADE Bank Common Equity Tier 1 capital / Total risk-weighted assets	35.1	% 38.3	% 34.2	%
E*TRADE Bank Tier 1 capital / Total risk-weighted assets	35.1	% 38.3	% 34.2	%
E*TRADE Bank total capital / Total risk-weighted assets	36.3	% 39.5	% 35.5	%

Under the regulatory guidelines for risk-based capital, on-balance sheet assets and credit equivalent amounts of derivatives and off-balance sheet items are assigned to one of several broad risk categories according to the obligor (1) 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.

#### Broker-Dealer Capital Requirements

Our broker-dealer subsidiaries are subject to capital requirements determined by their respective regulators. At June 30, 2017, all of our brokerage subsidiaries met their minimum net capital requirements. We continue to assess our ability to distribute excess net capital to the parent while maintaining adequate capital at the broker-dealers. E\*TRADE Securities paid dividends of \$120 million to the parent company during the six months ended June 30, 2017. For additional information on our broker-dealer capital requirements, see Note 13—Regulatory Requirements.

Table of Contents

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. Additionally, we enter into guarantees and other similar arrangements as part of transactions in the ordinary course of business. For additional information on these arrangements, see Note 14—Commitments, Contingencies and Other Regulatory Matters.

**RISK MANAGEMENT**

The identification, mitigation and management of existing and potential risks is critical to effective enterprise risk management. There are certain risks inherent to our industry (e.g. execution of transactions) and certain risks that will surface through the conduct of our business operations. We seek to monitor and manage our significant risk exposures by operating under a set of Board-approved limits and by monitoring certain risk indicators. Our governance framework is designed to comply with applicable requirements and requires regular reporting on metrics and significant risks and exposures to senior management and the Board of Directors.

We face the following key types of risks: credit, interest rate, liquidity, market, operational, information security, strategic, reputational as well as legal, regulatory and compliance. We have a Board-approved Enterprise Risk Appetite Statement (RAS) that is provided to all employees. The RAS specifies significant risk exposures and addresses the Company's tolerance of those risks, which are described in further detail within Part II. Item 7.

Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2016. We are also subject to other risks that could impact our business, financial condition, results of operations or cash flows in future periods. See Part I. Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2016.

**CONCENTRATIONS OF CREDIT RISK**

Credit risk is the risk of loss arising from the inability or failure of a borrower or counterparty to meet its credit obligations. Our loan portfolio represents our most significant credit risk exposure. See Part II. Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2016 for additional information on our management of credit risk.

Table of Contents

One- to Four-Family Interest-Only Loans

One- to four-family loans include loans with a five to ten year interest-only period, followed by an amortizing period ranging from 20 to 25 years. At June 30, 2017, 4% of our one- to four-family portfolio was not yet amortizing. This portfolio will be fully converted in 2018 with substantially all of the loans amortizing by September 30, 2017. The following chart outlines when one- to four-family loans convert to amortizing by percentage of the one- to four-family portfolio at June 30, 2017:

Home Equity Loans

The home equity loan portfolio consists of home equity installment loans (HEILs) and home equity lines of credit (HELOCs) and is primarily second lien loans on residential real estate properties that have a higher level of credit risk than first lien mortgage loans. HEILs are primarily fixed rate and fixed term, fully amortizing loans that do not offer the option of an interest-only payment. The majority of HELOCs had an interest only draw period at origination and converted to amortizing loans at the end of the draw period, which typically ranged from five to ten years. At June 30, 2017, 1% of the HELOC portfolio had not converted from the interest-only draw period and had not begun amortizing. This portfolio will be fully converted in 2019. The following chart outlines when HELOCs convert to amortizing by percentage of the HELOC portfolio at June 30, 2017:



Table of Contents

## Nonperforming Assets

We classify loans as nonperforming when they are no longer accruing interest, which includes loans that are 90 days and greater past due, TDRs that are on nonaccrual status for all classes of loans (including loans in bankruptcy) and certain junior liens that have a delinquent senior lien. The following table shows comparative data for nonperforming loans and assets at June 30, 2017 and December 31, 2016 (dollars in millions):

	June 30, December 31,	
	2017	2016
One- to four-family	\$ 205	\$ 215
Home equity	116	136
Consumer	—	1
Total nonperforming loans receivable	321	352
Real estate owned and other repossessed assets, net	29	36
Total nonperforming assets, net	\$ 350	\$ 388

## Allowance for Loan Losses

The allowance for loan losses is management's estimate of probable losses inherent in the loan portfolio at the balance sheet date, 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 includes a qualitative component to account for a variety of factors that present additional uncertainty that may not be fully considered in the quantitative loss model but are factors we believe may impact the level of credit losses. The following table presents the allowance for loan losses by loan portfolio at June 30, 2017 and December 31, 2016 (dollars in millions):

	One- to Four-Family		Home Equity		Consumer		Total	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
General reserve:								
Quantitative component	\$21	\$ 34	\$43	\$ 118	\$5	\$ 5	\$69	\$ 157
Qualitative component	1	4	1	2	—	—	2	6
Specific valuation allowance	7	7	38	51	—	—	45	58
Total allowance for loan losses	\$29	\$ 45	\$82	\$ 171	\$5	\$ 5	\$116	\$ 221
Allowance as a % of loans receivable <sup>(1)</sup>	1.7 %	2.3 %	6.4 %	11.0 %	2.1 %	1.9 %	3.6 %	5.8 %

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

Total loans receivable designated as held-for-investment decreased \$0.5 billion during the six months ended June 30, 2017. The allowance for loan losses was \$116 million, or 3.6% of total loans receivable, as of June 30, 2017 compared to \$221 million, or 5.8% of total loans receivable, as of December 31, 2016. The current period benefit for loan losses of \$99 million and \$113 million for the three and six months ended June 30, 2017, respectively, reflected approximately \$70 million of benefit resulting from refined default assumptions based on the sustained outperformance of converted mortgage loans that had been amortizing for 12 months or longer.

## Table of Contents

Net recoveries for the six months ended June 30, 2017 were \$8 million compared to \$9 million in the same period in 2016. The timing and magnitude of charge-offs and recoveries are affected by many factors and we anticipate variability from quarter to quarter.

For additional information on the loans portfolio and management's estimate of the allowance for loan losses, see Note 6—Loans Receivable, Net and Summary of Critical Accounting Policies and Estimates.

### Securities

We focus primarily on security type and credit rating to monitor credit risk in our securities portfolios. We consider securities backed by the U.S. government or its agencies to have low credit risk as the long-term debt rating of the U.S. government is AA+ by S&P and AAA by Moody's and Fitch at June 30, 2017. The amortized cost of these securities accounted for over 99% of our total securities portfolio at June 30, 2017. We review the remaining debt securities that were not backed by the U.S. government or its agencies according to their credit ratings from S&P, Moody's and Fitch where available. At June 30, 2017, all municipal bonds in our securities portfolio were rated investment grade (defined as a rating equivalent to a Moody's rating of "Baa3" or higher, or an S&P or Fitch rating of "BBB-" or higher).

### SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with GAAP. Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies in Part II. Item 8. Financial Statements and Supplementary Data in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 contains a summary of our significant accounting policies, many of which require the use of estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the periods presented. We believe that of our significant accounting policies, the following are critical because they are based on estimates and assumptions that require complex and subjective judgments by management: allowance for loan losses; valuation and impairment of goodwill and acquired intangible assets; and estimates of effective tax rates, deferred taxes and valuation allowance. Changes in these estimates or assumptions could materially impact our financial condition and results of operations, and actual results could differ from our estimates. With respect to the allowance for loan losses, we refined our default assumptions during the second quarter of 2017 based on the sustained outperformance of loans that reached the end of their interest-only period. Our remaining critical accounting policies are more fully described in Part II. Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Summary of Critical Accounting Policies and Estimates in our Annual Report on Form 10-K for the year ended December 31, 2016.

### 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 ongoing evaluations of the loan portfolio and loss forecasting assumptions. As of June 30, 2017, the allowance for loan losses was \$116 million on \$3.1 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. For loans that are not TDRs, we establish a general allowance and evaluate the adequacy of the allowance

## Table of Contents

for loan losses by loan portfolio segment: one- to four-family, home equity and consumer. For modified loans accounted for as TDRs that are valued using the discounted cash flow model, we establish a specific allowance by forecasting losses, including economic concessions to borrowers, over the estimated remaining life of these loans. The estimate of the allowance for loan losses continues to be 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
- General economic conditions

Total loans receivable designated as held-for-investment decreased \$0.5 billion during the six months ended June 30, 2017. The allowance for loan losses was \$116 million, or 3.6% of total loans receivable, as of June 30, 2017 compared to \$221 million, or 5.8% of total loans receivable, as of December 31, 2016. Benefit to provision for loan losses was \$99 million and \$113 million for the three and six months ended June 30, 2017, respectively.

The allowance for loan losses is typically equal to management's forecast of loan losses in the 18 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 quantitative allowance methodology also includes the identification of higher risk mortgage loans and the period of loan losses captured within the general allowance includes the total probable loss over the remaining life of these loans. As mortgage loan conversions from interest-only to amortizing have continued, at June 30, 2017, 99% of HELOCs and 96% of one- to four-family mortgages had converted. As of June 30, 2017, more than 50% of these converted loans had been amortizing 12 months or longer. This actual performance data is better than our performance assumptions, and combined with the substantial performance history, the uncertainty with respect to the population of converting loans has significantly decreased.

During the second quarter of 2017, management refined the default assumptions in the quantitative allowance methodology based on the sustained outperformance of converted mortgage loans that had been amortizing for 12 months or longer. This refinement resulted in approximately \$70 million of benefit to the provision for loan losses during the second quarter of 2017. In order to refine our default assumptions around the remaining population that had not yet started amortizing or that had not reached 12 months post conversion, we evaluated whether the credit quality and performance of these loans was consistent with the seasoned amortizing portfolio. We determined that FICO scores, LTV/CLTVs and delinquency rates were comparable to the seasoned portfolio, and therefore applied the refined default assumptions to this remaining population.

The general allowance for loan losses also included a qualitative component to account for a variety of factors that present additional uncertainty that may not be fully considered in the quantitative loss model but are factors we believe may impact the level of credit losses. We utilize a qualitative factor framework whereby, on a quarterly basis, management assesses the risk associated with three primary sets of factors: external factors, internal factors, and portfolio specific factors. The uncertainty related to these factors may expand over time, temporarily increasing the qualitative component in advance of the more precise

## Table of Contents

identification of these probable losses being captured within the quantitative component of the general allowance. The total qualitative component was \$2 million and \$6 million as of June 30, 2017 and December 31, 2016, respectively. Effects if Actual Results Differ

It is difficult to estimate how potential changes in the quantitative and qualitative factors, including the impact of loans converting from interest only to amortizing, might impact the allowance for loan losses. Our underlying assumptions and judgments could prove to be inaccurate, which could materially impact our 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.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following discussion about market risk 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 Part I. Item 1A. Risk Factors in the Annual Report on Form 10-K for the year ended December 31, 2016.

#### Interest Rate Risk

Our exposure to interest rate risk is related primarily to interest-earning assets and interest-bearing liabilities. Managing 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 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 to help manage exposures 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 otherwise change shape, which could affect 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 premiums 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 June 30, 2017, 92% of our total assets were interest-earning assets and we had no securities classified as trading.

At June 30, 2017, approximately 66% of total assets were available-for-sale and held-to-maturity mortgage-backed securities and residential real estate loans. 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.

Table of Contents

When real estate loans are prepaid, unamortized premiums and/or discounts are recognized immediately in interest income. Depending on the timing of the prepayment, these adjustments to income would impact anticipated yields. The Company 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 customer payables, both of which re-price at management's discretion. We may utilize wholesale funding sources as needed for short-term liquidity and contingency funding requirements.

Derivative Instruments

We use derivative instruments to help manage interest rate risk using designated hedge relationships. 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. See Note 7—Derivative Instruments and Hedging Activities for additional information about our use of derivative contracts.

Scenario Analysis

Scenario analysis is an advanced approach to estimating interest rate risk exposure. The Company monitors interest rate risk using the Economic Value of Equity (EVE) approach and the Earnings-at-Risk (EAR) approach.

Under the EVE approach, the present value of expected cash flows of all existing interest-earning assets, interest-bearing liabilities, derivatives and forward commitments are estimated and combined to produce an EVE figure. The change in EVE is a long-term sensitivity measure of interest rate risk. 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. The change in EVE amounts fluctuate based on instantaneous parallel shifts in interest rates primarily due to the change in timing of cash flows, which considers prepayment estimates, in the Company's residential loan and mortgage-backed securities portfolios.

EAR is a short-term sensitivity measure of interest rate risk and illustrates the impact of alternative interest rate scenarios on net interest income, including corporate interest expense, over a twelve month time frame. In measuring the sensitivity of net interest income to changes in interest rates, we assume instantaneous parallel interest rate shocks applied to the forward curve. In addition, we assume that cash flows from loan payoffs are reinvested in mortgage-backed securities, we exclude revenue from off-balance sheet customer cash and we assume no balance sheet growth.

The sensitivity of EAR and EVE at the consolidated E\*TRADE Financial level at June 30, 2017 and December 31, 2016 is as follows (dollars in millions):

Instantaneous Parallel Change in Interest Rates (basis points) <sup>(1)</sup>	Economic Value of Equity				Earnings-at-Risk			
	June 30, 2017		December 31, 2016		June 30, 2017		December 31, 2016	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
+200	\$(264)	(3.5 )%	\$(129)	(2.1 )%	\$169	11.4 %	\$169	13.9 %
+100	\$41	0.5 %	\$59	0.9 %	\$116	7.8 %	\$109	9.0 %
-50	\$(156)	(2.0 )%	\$(106)	(1.7 )%	\$(84 )	(5.6 )%	\$(73 )	(6.0 )%

(1) These scenario analyses assume a balance sheet size as of the dates indicated. Any changes in size would cause the amounts to vary.

Table of Contents

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. We compare the instantaneous parallel shift in interest rate changes in EVE and EAR to the established limits set by the Board of Directors in order to assess interest rate risk. In the event that the percentage change in EVE or EAR exceeds the Board limits, our Chief Executive Officer, Chief Risk Officer, Chief Financial Officer and Treasurer must all be promptly notified in writing and decide upon a plan of remediation. In addition, the Board of Directors must be notified of the exception and the planned resolution. At June 30, 2017, the EVE and EAR percentage changes were within our Board limits.

E\*TRADE | Q2 2017 10-Q 36

---

Table of Contents

**KEY TERMS**

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

Average commission per trade—Total commissions revenue divided by total number of revenue trades.

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

Basel III—Global regulatory standards for bank capital adequacy and liquidity as issued by the international Basel Committee on Banking Supervision.

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

Brokerage account attrition rate—The brokerage account attrition rate is calculated by dividing attriting brokerage accounts by total brokerage accounts from the previous period end, and is presented on an annualized basis. Attriting brokerage accounts are derived by subtracting net new brokerage accounts from gross new brokerage accounts.

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

BPO—Broker price opinion.

CFTC—Commodity Futures Trading Commission.

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

CLTV—Combined loan-to-value ratio.

Common Equity Tier 1 Capital—A measurement of the Company's core equity capital used in the calculation of capital adequacy ratios. Common Equity Tier 1 Capital equals: total shareholders' equity, less preferred stock and related surplus, plus/(less) unrealized losses (gains) on certain available-for-sale securities, less goodwill and certain other intangible assets, less certain disallowed deferred tax assets and subject to certain other applicable adjustments.

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

Consolidated financial statements—Refers to the consolidated financial statements prepared in accordance with GAAP as included in the Company's annual report on Form 10-K, and the condensed consolidated financial statements included in the Company's interim reports on Form 10-Q.

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 or notification.

Customer assets—Market value of all customer assets held by the Company including security holdings, sweep and other deposits, customer cash held by third parties, customer payables and vested unexercised stock plan holdings.

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 which includes one or more underlying securities, notional amounts, or payment provisions. The contract generally requires no initial net investment and is settled on a net basis.

Table of Contents

Derivative DARTs—Options and futures revenue trades in a period divided by the number of trading days during that period.

Earnings at Risk (EAR)—The sensitivity of GAAP net interest income to changes in interest rates over a twelve month horizon. It is a short-term measurement of interest rate risk and does not consider risks beyond the simulation time horizon. In addition, it requires reinvestment, funding, and hedging assumptions for the horizon.

Economic Value of Equity (EVE)—The sensitivity of the value of existing assets and liabilities, including derivatives and forward commitments, to changes in interest rates. It is a long-term measurement of interest rate risk and requires assumptions that include prepayment rates on the loan portfolio and mortgage-backed securities and the repricing of deposits.

ESDA—Extended insurance sweep deposit accounts.

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

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

FASB—Financial Accounting Standards Board.

FDIC—Federal Deposit Insurance Corporation.

Federal Reserve—Federal Reserve System, including the Federal Reserve Board of Governors and the twelve regional Federal Reserve Banks.

FHLB—Federal Home Loan Bank.

FICO—Fair Isaac Credit Organization.

FINRA—Financial Industry Regulatory Authority.

FCM—Futures Commission Merchant.

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

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

HEIL—Home equity installment loan.

HELOC—Home equity lines of credit.

HQLA—High-quality liquid assets.

Interest-bearing liabilities—Liabilities such as deposits, customer payables, other borrowings, corporate debt and certain customer credit balances and securities lending balances on which the Company pays interest; excludes customer balances held by third parties.

Interest-earning assets—Assets such as available-for-sale securities, held-to-maturity securities, margin receivables, loans, securities borrowed balances and cash and investments required to be segregated under regulatory guidelines that earn interest for the Company.

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 amounts.



Table of Contents

LCR—Liquidity coverage ratio. The purpose of LCR is to require banking organizations to hold minimum amounts of HQLA based on a percentage of their net cash outflows over a 30-day period.

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).

LLC—Limited liability company.

LTV—Loan-to-value ratio.

NASDAQ—National Association of Securities Dealers Automated Quotations.

Net interest income—A measure of interest revenue, net interest income is equal to interest income less interest expense.

Net interest margin—A measure of the net yield on our average interest-earning assets. Net interest margin is calculated for a given period by dividing the annualized sum of net interest income by average interest-earning assets.

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

NFA—National Futures Association.

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

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

OCC—Office of the Comptroller of the Currency.

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

RAS—Risk Appetite Statement.

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

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

Repurchase agreement—An agreement giving the transferor of an asset the right or obligation to repurchase the same or similar securities at a specified price on a given date from the transferee. These agreements are generally collateralized by mortgage-backed or investment-grade securities. From the transferee's perspective the arrangement is referred to as a reverse repurchase agreement.

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

S&P—Standard & Poor's.

SEC—U.S. Securities and Exchange Commission.

Table of Contents

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

Tier 1 capital—Adjusted equity capital used in the calculation of capital adequacy ratios. Tier 1 capital equals: Common Equity Tier 1 capital plus qualifying preferred stock and related surplus, subject to certain other applicable adjustments.

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

TRUPs—Trust preferred securities.

VIE—Variable interest entity.

Wholesale borrowings—Borrowings that consist of repurchase agreements and FHLB advances.

Table of Contents

## PART I - FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENT OF INCOME

(In millions, except share data and per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue:				
Interest income	\$378	\$ 306	\$719	\$ 614
Interest expense	(22 )	(20 )	(44 )	(41 )
Net interest income	356	286	675	573
Commissions	105	106	232	213
Fees and service charges	98	62	184	120
Gains on securities and other, net	7	10	17	20
Other revenue	11	10	22	20
Total non-interest income	221	188	455	373
Total net revenue	577	474	1,130	946
Provision (benefit) for loan losses	(99 )	(35 )	(113 )	(69 )
Non-interest expense:				
Compensation and benefits	133	125	269	251
Advertising and market development	42	30	85	73
Clearing and servicing	33	25	65	49
Professional services	24	22	46	44
Occupancy and equipment	29	24	56	47
Communications	36	20	61	43
Depreciation and amortization	20	20	40	40
FDIC insurance premiums	8	6	16	12
Amortization of other intangibles	9	5	18	10
Restructuring and acquisition-related activities	4	1	8	3
Other non-interest expenses	21	17	37	35
Total non-interest expense	359	295	701	607
Income before income tax expense	317	214	542	408
Income tax expense	124	81	204	122
Net income	\$193	\$ 133	\$338	\$ 286
Preferred stock dividends	—	—	13	—
Net income available to common shareholders	\$193	\$ 133	\$325	\$ 286
Basic earnings per common share	\$0.70	\$ 0.48	\$1.18	\$ 1.02
Diluted earnings per common share	\$0.70	\$ 0.48	\$1.17	\$ 1.01
Shares used in computation of per common share data:				
Basic (in thousands)	275,410		277,013	
Diluted (in thousands)	276,272		277,978	
See accompanying notes to the condensed consolidated financial statements				



Table of ContentsE\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(In millions)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$193	\$133	\$338	\$286
Other comprehensive income, net of tax				
Available-for-sale securities:				
Unrealized gains, net	42	69	88	163
Reclassification into earnings, net	(6 )	(9 )	(11 )	(18 )
Net change from available-for-sale securities	36	60	77	145
Reclassification of foreign currency translation gains	—	—	(2 )	—
Other comprehensive income	36	60	75	145
Comprehensive income	\$229	\$193	\$413	\$431
See accompanying notes to the condensed consolidated financial statements				

E\*TRADE | Q2 2017 10-Q 42

Table of ContentsE\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET

(In millions, except share data)

(Unaudited)

	June 30, 2017	December 31, 2016
<b>ASSETS</b>		
Cash and equivalents	\$ 1,091	\$ 1,950
Cash required to be segregated under federal or other regulations	889	1,460
Available-for-sale securities	18,890	13,892
Held-to-maturity securities (fair value of \$21,565 and \$15,716 at June 30, 2017 and December 31, 2016, respectively)	21,502	15,751
Margin receivables	7,773	6,731
Loans receivable, net (net of allowance for loan losses of \$116 million and \$221 million at June 30, 2017 and December 31, 2016, respectively)	3,055	3,551
Receivables from brokers, dealers and clearing organizations	1,237	1,056
Property and equipment, net	245	239
Goodwill	2,370	2,370
Other intangibles, net	303	320
Deferred tax assets, net	519	756
Other assets	879	923
Total assets	\$58,753	\$48,999
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Deposits	\$40,072	\$31,682
Customer payables	7,992	8,159
Payables to brokers, dealers and clearing organizations	1,473	983
Other borrowings	1,009	409
Corporate debt	992	994
Other liabilities	532	500
Total liabilities	52,070	42,727
Commitments and contingencies (see Note 14)		
<b>Shareholders' equity:</b>		
Preferred stock, \$0.01 par value, \$1,000 liquidation preference, shares authorized: 1,000,000 at June 30, 2017 and December 31, 2016; shares issued and outstanding: 400,000 at both June 30, 2017 and December 31, 2016	394	394
Common stock, \$0.01 par value, shares authorized: 400,000,000 at June 30, 2017 and December 31, 2016; shares issued and outstanding: 275,054,601 and 273,963,415 at June 30, 2017 and December 31, 2016, respectively	3	3
Additional paid-in-capital	6,929	6,921
Accumulated deficit	(581)	(909)
Accumulated other comprehensive loss	(62)	(137)
Total shareholders' equity	6,683	6,272
Total liabilities and shareholders' equity	\$58,753	\$48,999
See accompanying notes to the condensed consolidated financial statements		



Table of Contents

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

	Preferred Stock Amount	Common Stock Shares		Additional Paid-in Capital Amount	Accumulated Deficit		Accumulated Other Comprehensive Loss		Total Shareholders' Equity	
Balance at December 31, 2016	\$ 394	274	\$ 3	\$ 6,921	\$ (909	)	\$ (137	)	\$ 6,272	
Cumulative effect of accounting change	—	—	—	—	3		—		3	
Net income	—	—	—	—	338		—		338	
Other comprehensive income	—	—	—	—	—		75		75	
Conversion of convertible debentures	—	—	—	3	—		—		3	
Preferred stock dividends	—	—	—	—	(13	)	—		(13	)
Issuance of common stock for share-based compensation, net of shares withheld to pay taxes	—	1	—	(16	)	—	—		(16	)
Share-based compensation	—	—	—	21	—		—		21	
Balance at June 30, 2017	\$ 394	275	\$ 3	\$ 6,929	\$ (581	)	\$ (62	)	\$ 6,683	

	Preferred Stock Amount	Common Stock Shares		Additional Paid-in Capital Amount	Accumulated Deficit		Accumulated Other Comprehensive Income (Loss)		Total Shareholders' Equity	
Balance at December 31, 2015	\$ —	291	\$ 3	\$ 7,356	\$ (1,461	)	\$ (99	)	\$ 5,799	
Net income	—	—	—	—	286		—		286	
Other comprehensive income	—	—	—	—	—		145		145	
Conversion of convertible debentures	—	1	—	5	—		—		5	
Exercise of stock options and related tax effects	—	—	—	2	—		—		2	
Repurchases of common stock	—	(19	)	(452	)	—	—		(452	)
Issuance of common stock for share-based compensation, net of shares withheld to pay taxes	—	1	—	(14	)	—	—		(14	)
Share-based compensation	—	—	—	14	—		—		14	
Balance at June 30, 2016	\$ —	274	\$ 3	\$ 6,911	\$ (1,175	)	\$ 46		\$ 5,785	
See accompanying notes to the condensed consolidated financial statements										



Table of ContentsE\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(In millions)

(Unaudited)

	Six Months Ended June 30, 2017 2016	
Cash flows from operating activities:		
Net income	\$338	\$286
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (benefit) for loan losses	(113 )	(69 )
Depreciation and amortization (including discount amortization and accretion)	124	112
Gains on securities and other, net	(17 )	(20 )
Share-based compensation	21	14
Deferred tax expense	192	114
Other	(3 )	4
Net effect of changes in assets and liabilities:		
Decrease (increase) in cash required to be segregated under federal or other regulations	571	(764 )
Increase in receivables from brokers, dealers and clearing organizations	(189 )	(172 )
(Increase) decrease in margin receivables	(1,042)	574
Increase in other assets	(22 )	—
Increase in payables to brokers, dealers and clearing organizations	490	168
(Decrease) increase in customer payables	(167 )	168
Decrease in other liabilities	(11 )	(75 )
Net cash provided by operating activities	172	340
Cash flows from investing activities:		
Purchases of available-for-sale securities	(6,348)	(3,687)
Proceeds from sales of available-for-sale securities	795	1,621
Proceeds from maturities of and principal payments on available-for-sale securities	701	681
Purchases of held-to-maturity securities	(6,840)	(3,122)
Proceeds from maturities of and principal payments on held-to-maturity securities	1,107	864
Proceeds from sale of loans	40	—
Decrease in loans receivable	555	579
Capital expenditures for property and equipment	(50 )	(38 )
Proceeds from sale of real estate owned and repossessed assets	16	10
Net cash flow from derivative contracts	51	(56 )
Other	(19 )	(4 )
Net cash used in investing activities	(9,992)	(3,152)

Table of Contents

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

	Six Months Ended June 30,	
	2017	2016
Cash flows from financing activities:		
Increase in deposits	\$8,390	\$3,519
Preferred stock dividends	(13 )	—
Net increase (decrease) in securities sold under agreements to repurchase	400	(82 )
Advances from FHLB	400	—
Payments on advances from FHLB	(200 )	—
Repurchases of common stock	—	(452 )
Other	(16 )	(13 )
Net cash provided by financing activities	8,961	2,972
(Decrease) increase in cash and equivalents	(859 )	160
Cash and equivalents, beginning of period	1,950	2,233
Cash and equivalents, end of period	\$1,091	\$2,393
Supplemental disclosures:		
Cash paid for interest	\$41	\$59
Cash paid for income taxes, net of refunds	\$5	\$5
Non-cash investing and financing activities:		
Transfers of loans held-for-investment to loans held-for-sale	\$40	\$—
Transfers from loans to other real estate owned and repossessed assets	\$15	\$14
Conversion of convertible debentures to common stock	\$3	\$5
Transfer of available-for-sale securities to held-to-maturity securities	\$—	\$492
See accompanying notes to the condensed consolidated financial statements		

Table of Contents

E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Organization

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

Basis of Presentation

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

The Company's consolidated financial statements are prepared in accordance with GAAP. Intercompany accounts and transactions are eliminated in consolidation. These financial statements reflect all adjustments, which are normal and recurring in nature, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. These consolidated financial statements should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2016. While certain disclosures included in annual financial statements prepared in accordance with GAAP have been omitted in this quarterly report, the Company believes that the information and disclosures presented herein are adequate and that such disclosures are not misleading.

Use of Estimates

Preparing the Company's consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the periods presented. Actual results could differ from management's estimates. Certain significant accounting policies are critical because they are based on estimates and assumptions that require complex and subjective judgments by management. Changes in these estimates or assumptions could materially impact the Company's financial condition and results of operations. Material estimates in which management believes changes could reasonably occur include: allowance for loan losses; valuation and impairment of goodwill and acquired intangible assets; and estimates of effective tax rates, deferred taxes and valuation allowance.

## Table of Contents

### Adoption of New Accounting Standards

#### Accounting for Employee Share-Based Payments

In March 2016, the FASB amended the accounting guidance on employee share-based payments. Relevant changes in the amended guidance include the requirement to recognize all excess tax benefits and deficiencies upon exercise or vesting as income tax expense or benefit in the consolidated statement of income; to treat excess tax benefits and deficiencies as discrete items in the reporting period they occur; to not delay recognition of excess tax benefits until the tax benefit is realized through a reduction in current taxes payable; and to make an accounting policy election to either estimate forfeitures or account for them as they occur. The Company adopted the amended accounting guidance as of January 1, 2017 and recognized a \$3 million deferred tax asset and cumulative-effect adjustment to equity as of the beginning of the period. In addition, for the six months ended June 30, 2016 the Company reclassified \$13 million related to shares withheld to pay taxes from cash flows from operating activities to cash flows from financing activities. Forfeitures will continue to be estimated consistent with the Company's prior accounting policies. The impact to the Company's financial condition, results of operations and cash flows will vary based on, among other factors, the market price of the Company's common stock. During the six months ended June 30, 2017 the Company recognized a \$6 million income tax benefit in accordance with the new guidance.

#### New Accounting Standards Not Yet Adopted

##### Revenue Recognition on Contracts with Customers

In May 2014, the FASB amended the guidance on revenue recognition on contracts with customers. The new standard outlines a single comprehensive model for entities to apply in accounting for revenue arising from contracts with customers. The Company's accounting for net interest income is not expected to be impacted by the new standard. The FASB issued supplemental amendments to the new standard to clarify certain accounting guidance and provide narrow scope improvements and practical expedients during 2016. The amended guidance will be effective for annual and interim periods beginning on January 1, 2018 and may be applied on either a full retrospective or modified retrospective basis. The Company is in process of completing its evaluation of the new accounting guidance. This adoption is not expected to have a material impact on the Company's financial condition, results of operations or cash flows as the satisfaction of performance obligations under the new guidance is expected to be materially consistent with the Company's existing revenue recognition policies. Similarly, the amended guidance is not expected to have a material impact on the recognition of costs incurred to obtain new contracts.

##### Classification and Measurement of Financial Instruments

In January 2016, the FASB amended the accounting and disclosure guidance on the classification and measurement of financial instruments. Relevant changes in the amended guidance include the requirement that equity investments, excluding those accounted for under the equity method of accounting or those resulting in consolidation of the investee, be measured at fair value in the consolidated balance sheet with changes in fair value recognized in net income. For disclosure purposes, the Company will no longer be required to disclose the methods and significant assumptions used to estimate fair value for financial instruments measured at amortized cost in the consolidated balance sheet. The amended guidance will be effective for interim and annual periods beginning on January 1, 2018 and is required to be applied on a modified retrospective basis by means of a cumulative-effect adjustment to the consolidated balance sheet on that date. The Company is currently evaluating the impact of the new accounting guidance; however, the adoption is not expected to have a material impact on the Company's financial condition, results of operations or cash flows as debt securities represent the majority of the Company's investment portfolio.

## Table of Contents

### Accounting for Leases

In February 2016, the FASB amended the guidance on accounting for leases. The new standard requires lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by all qualifying leases with terms of more than twelve months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee remains substantially unchanged and depends on classification as a finance or operating lease. The new standard also requires quantitative and qualitative disclosures that provide information about the amounts related to leasing arrangements recorded in the consolidated financial statements. The new guidance will be effective for interim and annual periods beginning on January 1, 2019 and is required to be applied on a modified retrospective basis to the earliest period presented, which includes practical expedient options in certain circumstances. The Company is currently evaluating the impact of the new accounting guidance on the Company's financial condition, results of operations and cash flows; however, the Company's business model of providing services through digital platforms and via phone and online channels in addition to 30 regional branches may limit the impact of the amended lease accounting guidance to the Company's financial condition.

### Accounting for Credit Losses

In June 2016, the FASB amended the accounting guidance on accounting for credit losses. The amended guidance requires measurement of all expected credit losses for financial instruments and other commitments to extend credit held at the reporting date. For financial assets measured at amortized cost, factors such as historical experience, current conditions, and reasonable and supportable forecasts will be used to estimate expected credit losses. The amended guidance will also change the manner in which credit losses are recognized on debt securities classified as available-for-sale. The new guidance will be effective for interim and annual periods beginning January 1, 2020. Early adoption is permitted. The Company is currently evaluating the impact of the new accounting guidance on the Company's financial condition, results of operations and cash flows; however, given the recent performance of the Company's run-off legacy loan portfolio and the credit profile of the current investment securities portfolio, the Company does not expect the amended accounting guidance to have as significant of an impact as it could have if the Company were originating or purchasing loans.

### Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB amended the guidance on the presentation and classification of certain cash receipts and cash payments in the consolidated statement of cash flows to eliminate current diversity in practice. The new guidance will be effective for interim and annual periods beginning January 1, 2018 and must be applied using a retrospective transition method to each period presented. Early adoption is permitted. The Company does not expect the amended accounting guidance to have a significant impact on its consolidated statement of cash flows.

### Classification of Restricted Cash

In November 2016, the FASB amended the guidance on the presentation and classification of changes in restricted cash in the consolidated statement of cash flows to eliminate current diversity in practice. The amended guidance requires the consolidated statement of cash flows to explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. The guidance will be effective for interim and annual periods beginning January 1, 2018 and must be applied using a retrospective transition method to each period presented. Early adoption is permitted. The Company is currently evaluating the impact of the new presentation and classification guidance.

Table of Contents

Clarifying the Definition of a Business

In January 2017, the FASB issued guidance to clarify the definition of a business in order to assist companies in the evaluation of whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The amended guidance also removes the existing evaluation of a market participant's ability to replace missing elements and narrows the definition of output to achieve consistency with other topics. The guidance will be effective for interim and annual periods beginning January 1, 2018 and must be applied prospectively. Early adoption is permitted.

Simplifying the Test for Goodwill Impairment

In January 2017, the FASB issued guidance to simplify the test for goodwill impairment by eliminating Step 2 from the goodwill impairment test. The amended guidance requires the Company to perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized at the amount by which the carrying amount exceeds the fair value of the reporting unit; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Income tax effects resulting from any tax deductible goodwill should be considered when measuring the goodwill impairment loss, if applicable. The Company will still have the option to perform a qualitative assessment to conclude whether it is more likely than not that the carrying amount of the Company exceeds its fair value. The guidance will be effective for interim and annual periods beginning January 1, 2020 and must be applied prospectively. Early adoption is permitted.

Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued guidance to amend the amortization period for certain purchased callable debt securities held at a premium. The amended guidance shortens the amortization period for certain callable debt securities held at a premium by requiring the premium to be amortized to the earliest call date. The guidance does not amend the accounting for securities held at a discount. The guidance will be effective for interim and annual periods beginning January 1, 2019 and must be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Early adoption is permitted. Based on the current composition of the Company's securities portfolio, the new guidance is not expected to have a significant impact on the Company's financial condition or results of operations.

Table of Contents

## NOTE 2—INTEREST INCOME AND INTEREST EXPENSE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Interest income:				
Cash and equivalents	\$2	\$1	\$4	\$3
Cash required to be segregated under federal or other regulations	3	1	6	2
Available-for-sale securities	95	68	180	132
Held-to-maturity securities	137	107	257	210
Margin receivables	75	61	141	125
Loans	41	49	84	100
Broker-related receivables and other	1	1	1	1
Subtotal interest income	354	288	673	573
Other interest revenue <sup>(1)</sup>	24	18	46	41
Total interest income	378	306	719	614
Interest expense:				
Deposits	(1 )	(1 )	(2 )	(2 )
Customer payables	(2 )	(1 )	(3 )	(2 )
Other borrowings	(5 )	(4 )	(10 )	(9 )
Corporate debt	(13 )	(14 )	(27 )	(27 )
Subtotal interest expense	(21 )	(20 )	(42 )	(40 )
Other interest expense <sup>(2)</sup>	(1 )	—	(2 )	(1 )
Total interest expense	(22 )	(20 )	(44 )	(41 )
Net interest income	\$356	\$286	\$675	\$573

(1) Represents interest income on securities loaned.

(2) Represents interest expense on securities borrowed.

## NOTE 3—FAIR VALUE DISCLOSURES

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

Level 1—unadjusted quoted prices in active markets for identical assets or liabilities that are accessible by the Company

Level 2—quoted prices for similar assets and liabilities in an active market, 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

## Table of Contents

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

#### Mortgage-backed Securities

The Company's mortgage-backed securities portfolio is comprised of agency mortgage-backed securities which are guaranteed by U.S. government sponsored enterprises and federal agencies. The fair value of agency mortgage-backed securities was determined using a market approach with quoted market prices, recent transactions and spread data for identical or similar instruments. Agency mortgage-backed securities were categorized in Level 2 of the fair value hierarchy.

#### Other Debt Securities

The Company's fair value level classification of U.S. Treasuries is based on the original maturity dates of the securities and whether the securities are the most recent issuances of a given maturity. U.S. Treasuries with original maturities less than one year are classified as Level 1. U.S. Treasuries with original maturities longer than one year are classified as Level 1 if they represent the most recent issuance of a given maturity; otherwise, these securities are classified as Level 2.

The fair value measurements of agency debentures and 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.

All of the Company's municipal bonds were rated investment grade at June 30, 2017. These securities were valued using a market approach with pricing service valuations corroborated by recent market transactions for identical or similar bonds. Municipal bonds and corporate bonds were categorized in Level 2 of the fair value hierarchy.

#### Publicly Traded Equity Securities

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

#### Derivative Instruments

Interest rate swap and option contracts were valued with an income approach using pricing models that are commonly used by the financial services industry. The market observable inputs used in the pricing models include the swap curve, the volatility surface, and prime or overnight indexed swap basis from a financial data provider. The Company does not consider these models to involve significant judgment on the part of management, and the Company corroborated the fair value measurements with counterparty valuations. The Company's derivative instruments were categorized in Level 2 of the fair value hierarchy. The consideration of credit risk, the Company's or the counterparty's, did not result in an adjustment to the valuation of its derivative instruments in the periods presented.



Table of Contents

## Nonrecurring Fair Value Measurement Techniques

Certain other assets are recorded at fair value on a nonrecurring basis: 1) one- to four-family and home equity loans in which the amount of the loan balance in excess of the estimated current value of the underlying property less estimated selling costs has been charged-off; and 2) real estate owned that is carried at the lower of the property's carrying value or fair value less estimated selling costs.

The Company evaluates and reviews assets that have been subject to fair value measurement requirements on a quarterly basis in accordance with policies and procedures that were designed to be in compliance with guidance from the Company's regulators. These policies and procedures govern the frequency of the review, the use of acceptable valuation methods, and the consideration of estimated selling costs.

## Loans Receivable

Loans that have been delinquent for 180 days or that are in bankruptcy and certain TDR loan modifications are charged-off based on the estimated current value of the underlying property less estimated selling costs. Property valuations for these one- to four-family and home equity loans are based on the most recent "as is" property valuation data available, which may include appraisals, broker price opinions (BPOs), automated valuation models or updated values using home price indices. Subsequent to the recording of an initial fair value measurement, these loans continue to be measured at fair value on a nonrecurring basis, utilizing the estimated value of the underlying property less estimated selling costs. These property valuations are updated on a monthly, quarterly or semi-annual basis depending on the type of valuation initially used. If the valuation data obtained is significantly different from the valuation previously received, the Company reviews additional property valuation data to corroborate or update the valuation. 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. Recoveries of previously charged-off amounts are recognized within the allowance for loan losses when received.

## Real Estate Owned

Property valuations for real estate owned are based on the lowest value of the most recent property valuation data available, which may include appraisals, listing prices or approved offer prices.

Nonrecurring fair value measurements on one- to four-family and home equity loans and real estate owned were classified as Level 3 of the fair value hierarchy as the valuations included unobservable inputs that were significant to the fair value. The following table presents additional information about significant unobservable inputs used in the valuation of assets measured at fair value on a nonrecurring basis that were categorized in Level 3 of the fair value hierarchy at June 30, 2017 and December 31, 2016:

		Unobservable Inputs	Average	Range
June 30, 2017				
Loans receivable:				
One- to four-family	Appraised value	\$416,000		\$40,000-\$1,200,000
Home equity	Appraised value	\$320,500		\$29,500-\$1,990,000
Real estate owned	Appraised value	\$296,500		\$17,000-\$1,120,000
December 31, 2016				
Loans receivable:				
One- to four-family	Appraised value	\$408,100		\$50,000-\$1,490,000
Home equity	Appraised value	\$312,000		\$6,000-\$2,500,000
Real estate owned	Appraised value	\$342,300		\$21,500-\$1,800,000

Table of Contents

## Recurring and Nonrecurring Fair Value Measurements

Assets and liabilities measured at fair value at June 30, 2017 and December 31, 2016 are summarized in the following tables (dollars in millions):

	Level 1	Level 2	Level 3	Total Fair Value
June 30, 2017:				
Recurring fair value measurements:				
Assets				
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$—	\$17,380	\$—	\$17,380
Agency debentures	—	988	—	988
U.S. Treasuries	—	451	—	451
Agency debt securities	—	33	—	33
Municipal bonds	—	31	—	31
Total debt securities	—	18,883	—	18,883
Publicly traded equity securities	7	—	—	7
Total available-for-sale securities	7	18,883	—	18,890
Receivables from brokers, dealers and clearing organizations:				
U.S. Treasuries	134	—	—	134
Other assets:				
Derivative assets <sup>(1)</sup>	—	90	—	90
Total assets measured at fair value on a recurring basis <sup>(2)</sup>	\$141	\$18,973	\$—	\$19,114
Liabilities				
Other liabilities:				
Derivative liabilities <sup>(1)</sup>	\$—	\$38	\$—	\$38
Total liabilities measured at fair value on a recurring basis <sup>(2)</sup>	\$—	\$38	\$—	\$38
Nonrecurring fair value measurements:				
Loans receivable, net:				
One- to four-family	\$—	\$—	\$14	\$14
Home equity	—	—	19	19
Total loans receivable	—	—	33	33
Other assets:				
Real estate owned	—	—	20	20
Total assets measured at fair value on a nonrecurring basis <sup>(3)</sup>	\$—	\$—	\$53	\$53

(1) All derivative assets and liabilities were interest rate contracts at June 30, 2017. Information related to derivative instruments is detailed in Note 7—Derivative Instruments and Hedging Activities.

(2) Assets and liabilities measured at fair value on a recurring basis represented 33% and less than 1% of the Company's total assets and total liabilities, respectively, at June 30, 2017.

(3) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet at June 30, 2017, and for which a fair value measurement was recorded during the period.

Table of Contents

	Level 1	Level 2	Level 3	Total Fair Value
December 31, 2016:				
Recurring fair value measurements:				
Assets				
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$ —	\$ 12,634	\$ —	\$ 12,634
Agency debentures	—	788	—	788
U.S. Treasuries	—	407	—	407
Agency debt securities	—	24	—	24
Municipal bonds	—	32	—	32
Total debt securities	—	13,885	—	13,885
Publicly traded equity securities	7	—	—	7
Total available-for-sale securities	7	13,885	—	13,892
Other assets:				
Derivative assets <sup>(1)</sup>	—	165	—	165
Total assets measured at fair value on a recurring basis <sup>(2)</sup>	\$ 7	\$ 14,050	\$ —	\$ 14,057
Liabilities				
Other liabilities:				
Derivative liabilities <sup>(1)</sup>	\$ —	\$ 31	\$ —	\$ 31
Total liabilities measured at fair value on a recurring basis <sup>(2)</sup>	\$ —	\$ 31	\$ —	\$ 31
Nonrecurring fair value measurements:				
Loans receivable, net:				
One- to four-family	\$ —	\$ —	\$ 25	\$ 25
Home equity	—	—	21	21
Total loans receivable	—	—	46	46
Other assets:				
Real estate owned	—	—	35	35
Total assets measured at fair value on a nonrecurring basis <sup>(3)</sup>	\$ —	\$ —	\$ 81	\$ 81

(1) All derivative assets and liabilities were interest rate contracts at December 31, 2016. Information related to derivative instruments is detailed in Note 7—Derivative Instruments and Hedging Activities.

(2) Assets and liabilities measured at fair value on a recurring basis represented 29% and less than 1% of the Company's total assets and total liabilities, respectively, at December 31, 2016.

(3) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet at December 31, 2016, and for which a fair value measurement was recorded during the period.

Table of Contents

The following table presents gains and losses recognized on assets measured at fair value on a nonrecurring basis during the three and six months ended June 30, 2017 and 2016 (dollars in millions):

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	\$	\$	\$	\$
One- to four-family	\$ 1	\$ 1	\$ 2	\$ 2
Home equity	2	4	3	7
Total losses on loans receivable measured at fair value	\$ 3	\$ 5	\$ 5	\$ 9
Losses (gains) on real estate owned measured at fair value	\$ —	\$ 1	\$ (1)	\$ 1

## Transfers Between Levels 1, 2 and 3

For assets and liabilities measured at fair value on a recurring basis, the Company's transfers between levels of the fair value hierarchy are deemed to have occurred at the beginning of the reporting period on a quarterly basis. The Company had no transfers between levels during the six months ended June 30, 2017 and 2016.

## Recurring Fair Value Measurements Categorized within Level 3

For the periods presented, no assets or liabilities measured at fair value on a recurring basis were categorized within Level 3 of the fair value hierarchy.

Table of Contents

## 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 June 30, 2017 and December 31, 2016 (dollars in millions):

	June 30, 2017				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets</b>					
Cash and equivalents	\$1,091	\$1,091	\$—	\$—	\$ 1,091
Cash required to be segregated under federal or other regulations	\$889	\$889	\$—	\$—	\$ 889
Held-to-maturity securities:					
Agency mortgage-backed securities	\$18,426	\$—	\$18,479	\$—	\$ 18,479
Agency debentures	291	—	291	—	291
Agency debt securities	2,778	—	2,788	—	2,788
Other non-agency debt securities	7	—	—	7	7
Total held-to-maturity securities	\$21,502	\$—	\$21,558	\$7	\$ 21,565
Margin receivables <sup>(1)</sup>	\$7,773	\$—	\$7,773	\$—	\$ 7,773
Loans receivable, net:					
One- to four-family	\$1,642	\$—	\$—	\$1,676	\$ 1,676
Home equity	1,204	—	—	1,175	1,175
Consumer	209	—	—	209	209
Total loans receivable, net <sup>(2)</sup>	\$3,055	\$—	\$—	\$3,060	\$ 3,060
Receivables from brokers, dealers and clearing organizations <sup>(1)</sup>	\$1,103	\$—	\$1,103	\$—	\$ 1,103
<b>Liabilities</b>					
Deposits	\$40,072	\$—	\$40,072	\$—	\$ 40,072
Customer payables	\$7,992	\$—	\$7,992	\$—	\$ 7,992
Payables to brokers, dealers and clearing organizations	\$1,473	\$—	\$1,473	\$—	\$ 1,473
Other borrowings:					
Securities sold under agreements to repurchase	\$400	\$—	\$400	\$—	\$ 400
FHLB advances	\$200	\$—	\$200	\$—	\$ 200
Trust preferred securities	\$409	\$—	\$—	\$321	\$ 321
Total other borrowings	\$1,009	\$—	\$600	\$321	\$ 921
Corporate debt	\$992	\$—	\$1,040	\$—	\$ 1,040

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

(1) approximately \$11.0 billion and \$9.8 billion at June 30, 2017 and December 31, 2016, respectively. Of this amount, \$2.9 billion and \$2.0 billion had been pledged or sold in connection with securities loans and deposits with clearing organizations at June 30, 2017 and December 31, 2016, respectively.

(2) The carrying value of loans receivable, net includes the allowance for loan losses of \$116 million and loans that are recorded at fair value on a nonrecurring basis at June 30, 2017.

Table of Contents

	December 31, 2016				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Assets					
Cash and equivalents	\$ 1,950	\$ 1,950	\$ —	\$ —	\$ 1,950
Cash required to be segregated under federal or other regulations	\$ 1,460	\$ 1,460	\$ —	\$ —	\$ 1,460
Held-to-maturity securities:					
Agency mortgage-backed securities	\$ 12,868	\$ —	\$ 12,839	\$ —	\$ 12,839
Agency debentures	29	—	29	—	29
Agency debt securities	2,854	—	2,848	—	2,848
Total held-to-maturity securities	\$ 15,751	\$ —	\$ 15,716	\$ —	\$ 15,716
Margin receivables	\$ 6,731	\$ —	\$ 6,731	\$ —	\$ 6,731
Loans receivable, net:					
One- to four-family	\$ 1,918	\$ —	\$ —	\$ 1,942	\$ 1,942
Home equity	1,385	—	—	1,311	1,311
Consumer	248	—	—	249	249
Total loans receivable, net <sup>(1)</sup>	\$ 3,551	\$ —	\$ —	\$ 3,502	\$ 3,502
Receivables from brokers, dealers and clearing organizations	\$ 1,056	\$ —	\$ 1,056	\$ —	\$ 1,056
Liabilities					
Deposits	\$ 31,682	\$ —	\$ 31,681	\$ —	\$ 31,681
Customer Payables	\$ 8,159	\$ —	\$ 8,159	\$ —	\$ 8,159
Payables to brokers, dealers and clearing organizations	\$ 983	\$ —	\$ 983	\$ —	\$ 983
Trust preferred securities	\$ 409	\$ —	\$ —	\$ 288	\$ 288
Corporate debt	\$ 994	\$ —	\$ 1,050	\$ —	\$ 1,050

(1) The carrying value of loans receivable, net includes the allowance for loan losses of \$221 million and loans that are recorded at fair value on a nonrecurring basis at December 31, 2016.

The fair value measurement techniques for financial instruments not carried at fair value on the consolidated balance sheet at June 30, 2017 and December 31, 2016 are summarized as follows:

Cash and equivalents, cash required to be segregated under federal or other regulations, margin receivables, receivables from brokers, dealers and clearing organizations, customer payables and payables to brokers, dealers and clearing organizations—Due to their short term nature, fair value is estimated to be carrying value.

Held-to-maturity securities—The held-to-maturity securities portfolio included agency mortgage-backed securities, agency debentures, agency debt securities, and other non-agency debt securities. The fair value of held-to-maturity securities is determined consistently with the pricing of available-for-sale securities described above.

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 and pricing features.

Assumptions for expected losses, prepayments, cash flows and discount rates are adjusted to reflect the individual characteristics of the loans, such as credit risk, coupon, lien position, and payment characteristics, as well as the secondary market conditions for these types of loans.

Although the market for one- to four-family and home equity loan portfolios has improved, given the lack of observability of valuation inputs, these fair value measurements cannot be determined with precision and changes in the underlying assumptions used, including discount rates, could significantly affect the results

Table of Contents

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 lower than both the carrying value and the estimated fair value of the portfolio.

Deposits—For certificates of deposit, fair value is estimated using a discounted cash flow model. For the remainder of deposits, fair value is the amount payable on demand at the reporting date.

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

Trust preferred securities—For subordinated debentures, fair value is estimated by discounting future cash flows at the yield implied by dealer pricing quotes.

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

**Fair Value of Commitments and Contingencies**

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. Changes in the economy or interest rates may influence the impact that these commitments and contingencies have on the Company in the future. The Company does not estimate the fair value of those commitments. The Company has the right to cancel these commitments in certain circumstances and has closed a significant amount of customer HELOCs in the past ten years. Information related to such commitments and contingent liabilities is included in Note 14—Commitments, Contingencies and Other Regulatory Matters.

Table of Contents**NOTE 4—OFFSETTING ASSETS AND LIABILITIES**

For financial statement purposes, the Company does not offset derivative instruments or securities borrowing and securities lending transactions. These activities are generally transacted under master agreements that are widely used by counterparties and that may allow for net settlements of payments in the normal course, as well as offsetting of all contracts with a given counterparty in the event of bankruptcy or default of one of the two parties to the transaction. The following table presents information about these transactions to enable the users of the Company's consolidated financial statements to evaluate the potential effect of rights of set-off between these recognized assets and liabilities at June 30, 2017 and December 31, 2016 (dollars in millions):

				Gross Amounts Not Offset in the Consolidated Balance Sheet			
	Gross Amounts of Recognized Assets and Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts Presented in the Consolidated Balance Sheet <sup>(1)</sup>	Financial Instruments	Collateral Received or Pledged (Including Cash)	Net Amount	
June 30, 2017							
Assets:							
Deposits paid for securities borrowed (2)	\$ 668	\$	—\$ 668	\$(225)	\$(425)	)	\$ 18
Total	\$ 668	\$	—\$ 668	\$(225)	\$(425)	)	\$ 18
Liabilities:							
Deposits received for securities loaned <sup>(3)</sup>	\$ 1,420	\$	—\$ 1,420	\$(225)	\$(1,077)	)	\$ 118
Repurchase agreements <sup>(4)</sup>	400	—	400	—	(400)	)	—
Derivative liabilities <sup>(5)(6)</sup>	7	—	7	—	(7)	)	—
Total	\$ 1,827	\$	—\$ 1,827	\$(225)	\$(1,484)	)	\$ 118
December 31, 2016							
Assets:							
Deposits paid for securities borrowed (2)	\$ 774	\$	—\$ 774	\$(192)	\$(560)	)	\$ 22
Total	\$ 774	\$	—\$ 774	\$(192)	\$(560)	)	\$ 22



## Liabilities:

Deposits received for securities loaned <sup>(3)</sup>	\$ 926	\$	—	\$ 926	\$(192)	\$(661)	)	\$ 73
Derivative liabilities <sup>(5)(6)</sup>	6	—	6	—	(6)	)	—	
Total	\$ 932	\$	—	\$ 932	\$(192)	\$(667)	)	\$ 73

(1) Net amount of deposits paid for securities borrowed are reflected in the receivables from brokers, dealers and clearing organizations line item in the consolidated balance sheet. Net amount of deposits received for securities loaned and derivative liabilities are reflected in the payables to brokers, dealers and clearing organizations and other liabilities line items in the consolidated balance sheet, respectively.

(2) Included in the gross amounts of deposits paid for securities borrowed was \$435 million and \$307 million at June 30, 2017 and December 31, 2016, respectively, transacted through a program with a clearing organization, which guarantees the return of cash to the Company. For presentation purposes, these amounts presented are based on the counterparties under the Company's master securities loan agreements.

## Table of Contents

- Included in the gross amounts of deposits received for securities loaned was \$871 million and \$546 million at June 30, 2017 and December 31, 2016, respectively, transacted through a program with a clearing organization, which
- (3) guarantees the return of securities to the Company. For presentation purposes, these amounts presented are based on the counterparties under the Company's master securities loan agreements.
  - (4) Collateral pledged included held-to-maturity securities at amortized cost and available-for-sale securities at fair value at June 30, 2017.
  - (5) Excludes net accrued interest payable of \$2 million at both June 30, 2017 and December 31, 2016.
  - (6) Collateral pledged included held-to-maturity securities at amortized cost at both June 30, 2017 and December 31, 2016.

### Securities Lending Transactions

Deposits paid for securities borrowed and deposits received for securities loaned are recorded at the amount of cash collateral advanced or received. Securities borrowing transactions require the Company to deposit cash with the lender whereas securities lending transactions result in the Company receiving collateral in the form of cash, with both requiring cash in an amount generally in excess of the market value of the securities. These transactions have overnight or continuous remaining contractual maturities.

Securities lending transactions expose the Company to counterparty credit risk and market risk. To manage the counterparty risk, the Company maintains internal standards for approving counterparties, reviews and analyzes the credit rating of each counterparty, and monitors its positions with each counterparty on an ongoing basis. In addition, for certain of the Company's securities lending transactions, the Company uses a program with a clearing organization that guarantees the return of securities. The Company monitors the market value of the securities borrowed and loaned using collateral arrangements that require additional collateral to be obtained from or excess collateral to be returned to the counterparties based on changes in market value, to maintain specified collateral levels.

### Repurchase Agreements

Repurchase agreements are collateralized borrowing transactions utilized by the Company for short-term liquidity and funding requirements. These agreements give the Company, as the transferor of collateral to a counterparty, the right or obligation to repurchase the same or similar collateral at a specified price on a given date. Repurchase agreements utilized by the Company are generally collateralized by mortgage-backed or other investment-grade securities. The counterparties retain possession of the collateral until maturity of the agreement.

### Derivative Transactions

Certain types of derivatives that the Company utilizes in its hedging activities are subject to derivatives clearing agreements (cleared derivatives contracts) under the Dodd-Frank Act. These cleared derivatives contracts enable clearing by a derivatives clearing organization through a clearing member. Under the contracts, the clearing member typically has a one-way right to offset all contracts in the event of the Company's default or bankruptcy. Collateral exchanged under these contracts is not included in the table above as the contracts may not qualify as master netting agreements. At June 30, 2017 and December 31, 2016, the Company had \$90 million and \$165 million, respectively, of cleared derivative contract assets. At June 30, 2017 and December 31, 2016, the Company had \$31 million and \$25 million, respectively, of cleared derivative contract liabilities.

In January 2017, a clearing organization through which the Company executes certain of its derivative contracts amended its rulebook to legally characterize variation margin payments as settlements of the derivatives' exposure rather than collateral against the exposure. For these contracts, amounts exchanged with counterparties are reflected as a reduction of the related derivative assets or liabilities, including accrued interest, on the consolidated balance sheet. At June 30, 2017, the Company had derivative assets and liabilities of \$13 million and \$20 million, respectively, excluding accrued interest, that were settled by variation margin payments and are therefore excluded from the table above.



Table of Contents

## 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 June 30, 2017 and December 31, 2016 are shown in the following tables (dollars in millions):

	Amortized Cost	Gross Unrealized / Unrecognized Gains	Gross Unrealized / Unrecognized Losses	Fair Value
June 30, 2017:				
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$ 17,542	\$ 60	\$ (222 )	\$ 17,380
Agency debentures	969	33	(14 )	988
U.S. Treasuries	453	6	(8 )	451
Agency debt securities	34	—	(1 )	33
Municipal bonds	31	—	—	31
Total debt securities	19,029	99	(245 )	18,883
Publicly traded equity securities <sup>(1)</sup>	7	—	—	7
Total available-for-sale securities	\$ 19,036	\$ 99	\$ (245 )	\$ 18,890
Held-to-maturity securities:				
Agency mortgage-backed securities	\$ 18,426	\$ 168	\$ (115 )	\$ 18,479
Agency debentures	291	1	(1 )	291
Agency debt securities	2,778	30	(20 )	2,788
Other non-agency debt securities	7	—	—	7
Total held-to-maturity securities	\$ 21,502	\$ 199	\$ (136 )	\$ 21,565
December 31, 2016:				
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$ 12,946	\$ 24	\$ (336 )	\$ 12,634
Agency debentures	791	18	(21 )	788
U.S. Treasuries	452	—	(45 )	407
Agency debt securities	25	—	(1 )	24
Municipal bonds	32	—	—	32
Total debt securities	14,246	42	(403 )	13,885
Publicly traded equity securities <sup>(1)</sup>	7	—	—	7
Total available-for-sale securities	\$ 14,253	\$ 42	\$ (403 )	\$ 13,892
Held-to-maturity securities:				
Agency mortgage-backed securities	\$ 12,868	\$ 123	\$ (152 )	\$ 12,839
Agency debentures	29	—	—	29
Agency debt securities	2,854	26	(32 )	2,848
Total held-to-maturity securities	\$ 15,751	\$ 149	\$ (184 )	\$ 15,716

(1) Consists of investments in a mutual fund related to the Community Reinvestment Act.

Table of Contents

## Contractual Maturities

The contractual maturities of all available-for-sale and held-to-maturity debt securities at June 30, 2017 are shown in the following table (dollars in millions):

	Amortized Cost	Fair Value
Available-for-sale debt securities:		
Due within one year	\$ 4	\$4
Due within one to five years	57	56
Due within five to ten years	7,221	7,149
Due after ten years	11,747	11,674
Total available-for-sale debt securities	\$ 19,029	\$18,883
Held-to-maturity debt securities:		
Due within one year	\$ 209	\$210
Due within one to five years	1,786	1,829
Due within five to ten years	5,060	5,083
Due after ten years	14,447	14,443
Total held-to-maturity debt securities	\$ 21,502	\$21,565

At June 30, 2017 and December 31, 2016, the Company pledged \$3.6 billion and \$0.5 billion, respectively, of held-to-maturity debt securities, and \$317 million and \$6 million of available-for-sale securities, respectively, for the same periods, as collateral for repurchase agreements, FHLB advances, derivatives and other purposes.

Table of Contents

## Investments with Unrealized or Unrecognized Losses

The following tables show the fair value and unrealized or unrecognized losses on available-for-sale and held-to-maturity securities, aggregated by investment category, and the length of time that individual securities have been in a continuous unrealized or unrecognized loss position at June 30, 2017 and December 31, 2016 (dollars in millions):

	Less than 12 Months		12 Months or More		Total	Unrealized /	
	Fair Value	Unrealized / Unrecognized Losses	Fair Value	Unrealized / Unrecognized Losses	Fair Value	Unrealized / Unrecognized Losses	
June 30, 2017:							
Available-for-sale securities:							
Debt securities:							
Agency mortgage-backed securities	\$8,277	\$ (173 )	\$1,813	\$ (49 )	\$10,090	\$ (222 )	
Agency debentures	374	(14 )	—	—	374	(14 )	
U.S. Treasuries	290	(8 )	—	—	290	(8 )	
Agency debt securities	33	(1 )	—	—	33	(1 )	
Municipal bonds	12	—	—	—	12	—	
Publicly traded equity securities	7	—	—	—	7	—	
Total temporarily impaired available-for-sale securities	\$8,993	\$ (196 )	\$1,813	\$ (49 )	\$10,806	\$ (245 )	
Held-to-maturity securities:							
Agency mortgage-backed securities	\$6,910	\$ (88 )	\$1,148	\$ (27 )	\$8,058	\$ (115 )	
Agency debentures	161	(1 )	—	—	161	(1 )	
Agency debt securities	1,483	(20 )	17	—	1,500	(20 )	
Total temporarily impaired held-to-maturity securities	\$8,554	\$ (109 )	\$1,165	\$ (27 )	\$9,719	\$ (136 )	
December 31, 2016:							
Available-for-sale securities:							
Debt securities:							
Agency mortgage-backed securities	\$9,281	\$ (279 )	\$1,620	\$ (57 )	\$10,901	\$ (336 )	
Agency debentures	454	(21 )	—	—	454	(21 )	
U.S. Treasuries	407	(45 )	—	—	407	(45 )	
Agency debt securities	24	(1 )	—	—	24	(1 )	
Municipal bonds	13	—	—	—	13	—	
Publicly traded equity securities	7	—	—	—	7	—	
Total temporarily impaired available-for-sale securities	\$10,186	\$ (346 )	\$1,620	\$ (57 )	\$11,806	\$ (403 )	
Held-to-maturity securities:							
Agency mortgage-backed securities	\$5,929	\$ (123 )	\$1,272	\$ (29 )	\$7,201	\$ (152 )	
Agency debentures	18	—	—	—	18	—	
Agency debt securities	1,739	(32 )	18	—	1,757	(32 )	
Total temporarily impaired held-to-maturity securities	\$7,686	\$ (155 )	\$1,290	\$ (29 )	\$8,976	\$ (184 )	



Table of Contents

The Company does not believe that any individual unrealized loss in the available-for-sale portfolio or unrecognized loss in the held-to-maturity portfolio as of June 30, 2017 represents a credit loss. The Company does not intend to sell the debt securities in an unrealized or unrecognized loss position as of the balance sheet date and it is not more likely than not that the Company will be required to sell the debt securities before the anticipated recovery of its remaining amortized cost of the debt securities in an unrealized or unrecognized loss position at June 30, 2017.

There were no impairment losses recognized in earnings on available-for-sale or held-to-maturity securities during the six months ended June 30, 2017 and 2016, respectively.

**Gains on Securities and Other, Net**

The following table shows the components of the gains on securities and other, net line item on the consolidated statement of income for the three and six months ended June 30, 2017 and 2016 (dollars in millions):

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
Gains on available-for-sale securities	\$ 10	\$ 14	\$ 18	\$ 29
Hedge ineffectiveness	(2 )	(2 )	(3 )	(4 )
Equity method investment income (loss) and other	(1 )	(2 )	2	(5 )
Gains on securities and other, net	\$ 7	\$ 10	\$ 17	\$ 20

**NOTE 6—LOANS RECEIVABLE, NET**

Loans receivable, net at June 30, 2017 and December 31, 2016 are summarized as follows (dollars in millions):

	June 30, 2017	December 31, 2016
One- to four-family	\$1,659	\$ 1,950
Home equity	1,287	1,556
Consumer	212	250
Total loans receivable	3,158	3,756
Unamortized premiums, net	13	16
Allowance for loan losses	(116 )	(221 )
Total loans receivable, net	\$3,055	\$ 3,551

During the three months ended June 30, 2017, the Company sold certain loans with a carrying value of \$41 million for proceeds that approximated book value.

At June 30, 2017, the Company pledged \$2.6 billion and \$0.2 billion of loans as collateral to the FHLB and Federal Reserve Bank of Richmond, respectively. At December 31, 2016, the Company pledged \$3.1 billion and \$0.3 billion of loans as collateral to the FHLB and Federal Reserve Bank of Richmond, respectively.



Table of Contents

The following table presents 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 by loan class at June 30, 2017 and December 31, 2016 (dollars in millions):

	Recorded Investment		Allowance for Loan Losses	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
Collectively evaluated for impairment:				
One- to four-family	\$1,445	\$ 1,717	\$ 22	\$ 38
Home equity	1,109	1,361	44	120
Consumer	214	253	5	5
Total collectively evaluated for impairment	2,768	3,331	71	163
Individually evaluated for impairment:				
One- to four-family	225	246	7	7
Home equity	178	195	38	51
Total individually evaluated for impairment	403	441	45	58
Total	\$3,171	\$ 3,772	\$ 116	\$ 221

**Credit Quality and Concentrations of Credit Risk**

The Company tracks and reviews factors to predict and monitor credit risk in its mortgage loan portfolio on an ongoing basis. These factors include: loan type, estimated current LTV/CLTV ratios, delinquency history, borrowers' current credit scores, housing prices, loan vintage and geographic location of the property. The Company believes LTV/CLTV ratios and credit scores are the key factors in determining future loan performance. 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 loan portfolio on at least a quarterly basis.

Table of Contents

## Credit Quality

The following tables show the distribution of the Company's mortgage loan portfolios by credit quality indicator at June 30, 2017 and December 31, 2016 (dollars in millions):

	One- to Four-Family		Home Equity	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
Current LTV/CLTV <sup>(1)</sup>				
<=80%	\$1,135	\$1,308	\$592	\$686
80%-100%	334	413	349	414
100%-120%	99	143	214	274
>120%	91	86	132	182
Total mortgage loans receivable	\$1,659	\$1,950	\$1,287	\$1,556
Average estimated current LTV/CLTV <sup>(2)</sup>	73	% 73	% 85	% 87
Average LTV/CLTV at loan origination <sup>(3)</sup>	71	% 71	% 81	% 81

(1) Current CLTV calculations for home equity loans are based on the maximum available line for HELOCs and outstanding principal balance for home equity installment loans. For home equity loans in the second lien position, the original balance of the first lien loan at origination date and updated valuations on the property underlying the loan are used to calculate CLTV. Current property value estimates are updated on a quarterly basis.

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

(3) Average LTV/CLTV at loan origination calculations are based on LTV/CLTV at time of purchase for one- to four-family purchased loans and home equity installment loans and maximum available line for HELOCs

	One- to Four-Family		Home Equity	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
Current FICO				
>=720	\$941	\$ 1,121	\$639	\$ 778
719 - 700	153	179	127	156
699 - 680	115	153	109	141
679 - 660	109	121	92	117
659 - 620	141	154	125	149
<620	200	222	195	215
Total mortgage loans receivable	\$1,659	\$ 1,950	\$1,287	\$ 1,556

Table of Contents

## Concentrations of Credit Risk

The following table outlines when one- to four-family and HELOCs convert to amortizing by percentage of the one- to four-family portfolio and HELOC portfolios, respectively, at June 30, 2017:

Period of Conversion to Amortizing Loan	% of One- to Four-Family Portfolio	% of Home Equity Line of Credit Portfolio
Already amortizing	96%	99%
Q3 2017	4%	—%
Q4 2017 or later	—%	1%

The average age of our mortgage loans receivable was 11.3 and 10.8 years at June 30, 2017 and December 31, 2016, respectively. Approximately 35% and 36% of the Company's mortgage loans receivable were concentrated in California at June 30, 2017 and December 31, 2016, respectively. No other state had concentrations of mortgage loans that represented 10% or more of the Company's mortgage loans receivable at June 30, 2017 and December 31, 2016.

## Delinquent Loans

The following table shows total loans receivable by delinquency category at June 30, 2017 and December 31, 2016 (dollars in millions):

	Current	30-89 Days Delinquent	90-179 Days Delinquent	180+ Days Delinquent	Total
June 30, 2017					
One- to four-family	\$ 1,488	\$ 62	\$ 28	\$ 81	\$ 1,659
Home equity	1,192	37	18	40	1,287
Consumer	208	4	—	—	212
Total loans receivable	\$ 2,888	\$ 103	\$ 46	\$ 121	\$ 3,158
December 31, 2016					
One- to four-family	\$ 1,774	\$ 67	\$ 23	\$ 86	\$ 1,950
Home equity	1,442	43	18	53	1,556
Consumer	245	4	1	—	250
Total loans receivable	\$ 3,461	\$ 114	\$ 42	\$ 139	\$ 3,756

One- to four-family loans are generally secured in a first lien position by real estate assets, reducing the potential loss when compared to an unsecured loan. Home equity loans are generally secured by real estate assets; however, the majority of these loans are secured in a second lien position, which substantially increases the potential loss when compared to a first lien position. The loss severity of our second lien home equity loans was approximately 85% for a trailing twelve-month period as of June 30, 2017.

Table of Contents

## Nonperforming Loans

The following table shows the comparative data for nonperforming loans at June 30, 2017 and December 31, 2016 (dollars in millions):

	June 30, 2017	December 31, 2016
One- to four-family	\$205	\$ 215
Home equity	116	136
Consumer	—	1
Total nonperforming loans receivable	\$321	\$ 352

At June 30, 2017 and December 31, 2016, the Company held \$29 million and \$35 million, respectively, of real estate owned that were acquired through foreclosure or through a deed in lieu of foreclosure or similar legal agreement. The Company held \$102 million and \$112 million of loans for which formal foreclosure proceedings were in process at June 30, 2017 and December 31, 2016, respectively.

Table of Contents

## Allowance for Loan Losses

The following table provides a roll forward by loan portfolio of the allowance for loan losses for the three and six months ended June 30, 2017 and 2016 (dollars in millions):

	Three Months Ended June 30, 2017			
	One- to Four-	Home Equity Family	Consumer	Total
Allowance for loan losses, beginning of period	\$46	\$162	\$ 5	\$213
Provision (benefit) for loan losses	(18 )	(81 )	—	(99 )
Charge-offs	—	(5 )	(1 )	(6 )
Recoveries	1	6	1	8
Net (charge-offs) recoveries	1	1	—	2
Allowance for loan losses, end of period	\$29	\$82	\$ 5	\$116

	Three Months Ended June 30, 2016			
	One- to Four-	Home Equity Family	Consumer	Total
Allowance for loan losses, beginning of period	\$49	\$267	\$ 6	\$322
Provision (benefit) for loan losses	(8 )	(28 )	1	(35 )
Charge-offs	—	(4 )	(2 )	(6 )
Recoveries	1	10	1	12
Net (charge-offs) recoveries	1	6	(1 )	6
Allowance for loan losses, end of period	\$42	\$245	\$ 6	\$293

	Six Months Ended June 30, 2017			
	One- to Four-	Home Equity Family	Consumer	Total
Allowance for loan losses, beginning of period	\$45	\$171	\$ 5	\$221
Provision (benefit) for loan losses	(18 )	(96 )	1	(113 )
Charge-offs	—	(5 )	(3 )	(8 )
Recoveries	2	12	2	16
Net (charge-offs) recoveries	2	7	(1 )	8
Allowance for loan losses, end of period	\$29	\$82	\$ 5	\$116

	Six Months Ended June 30, 2016			
	One- to Four-	Home Equity Family	Consumer	Total
Allowance for loan losses, beginning of period	\$40	\$307	\$ 6	\$353
Provision (benefit) for loan losses	—	(70 )	1	(69 )
Charge-offs	(1 )	(9 )	(4 )	(14 )
Recoveries	3	17	3	23
Net (charge-offs) recoveries	2	8	(1 )	9
Allowance for loan losses, end of period	\$42	\$245	\$ 6	\$293

E\*TRADE | Q2 2017 10-Q 70

---

Table of Contents

During the three months ended June 30, 2017, the Company refined the default assumptions in the quantitative allowance methodology based on the sustained outperformance of converted mortgage loans that had been amortizing for 12 months or longer. This refinement resulted in approximately \$70 million of benefit to the provision for loan losses during the second quarter of 2017. In order to refine the default assumptions around the remaining population that had not yet started amortizing or that had not reached 12 months post conversion, the Company evaluated whether the credit quality and performance of these loans was consistent with the seasoned amortizing portfolio. The Company determined that FICO scores, LTV/CLTVs and delinquency rates were comparable to the seasoned portfolio, and therefore applied the refined default assumptions to this remaining population. The current period benefit also reflected recoveries in excess of prior estimates, including recoveries of previous charge-offs.

**Impaired Loans—Troubled Debt Restructurings**

The following table shows a summary of the Company's recorded investment in TDRs that were on accrual and nonaccrual status, further disaggregated by delinquency status, in addition to the recorded investment in TDRs at June 30, 2017 and December 31, 2016 (dollars in millions):

	Accrual TDRs <sup>(1)</sup>	Nonaccrual TDRs				Total Recorded Investment in TDRs <sup>(3)(4)</sup>
		Current	30-89	90-179	180+ Days	
			Days Delinquent	Days Delinquent	Delinquent	
June 30, 2017						
One- to four-family	\$ 88	\$80	\$ 15	\$ 9	\$ 33	\$ 225
Home equity	111	38	9	4	16	178
Total	\$ 199	\$118	\$ 24	\$ 13	\$ 49	\$ 403
December 31, 2016						
One- to four-family	\$ 97	\$90	\$ 16	\$ 8	\$ 35	\$ 246
Home equity	119	41	10	4	21	195
Total	\$ 216	\$131	\$ 26	\$ 12	\$ 56	\$ 441

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

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

The unpaid principal balance in one- to four-family TDRs was \$223 million and \$243 million at June 30, 2017 and December 31, 2016, respectively. For home equity loans, the recorded investment in TDRs represents the unpaid principal balance.

Total recorded investment in TDRs at June 30, 2017 consisted of \$295 million of loans modified as TDRs and \$108 million of loans that have been charged off due to bankruptcy notification. Total recorded investment in TDRs at December 31, 2016 consisted of \$316 million of loans modified as TDRs and \$125 million of loans that have been charged off due to bankruptcy notification.

The recorded investment in loans modified as TDRs includes the charge-offs related to certain loans that were written down to estimated current value of the underlying property less estimated selling costs. These charge-offs were recorded on modified loans that were delinquent in excess of 180 days, in bankruptcy, or when certain characteristics of the loan, including CLTV, borrower's credit and type of modification, cast substantial doubt on the borrower's ability to repay the loan.

Table of Contents

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 six months ended June 30, 2017 and 2016 (dollars in millions):

	Average Recorded Investment Three Months Ended June 30, 2017		Interest Income Recognized Three Months Ended June 30, 2016	
One- to four-family	\$231	\$278	\$ 2	\$ 3
Home equity	184	206	4	4
Total	\$415	\$484	\$ 6	\$ 7

	Average Recorded Investment Six Months Ended June 30, 2017		Interest Income Recognized Six Months Ended June 30, 2016	
One- to four-family	\$236	\$280	\$ 5	\$ 5
Home equity	188	206	8	8
Total	\$424	\$486	\$ 13	\$ 13

The following table shows detailed information related to the Company's TDRs and specific valuation allowances at June 30, 2017 and December 31, 2016 (dollars in millions):

	June 30, 2017			December 31, 2016		
	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	\$57	\$ 7	\$ 50	\$61	\$ 7	\$ 54
Home equity	\$95	\$ 38	\$ 57	\$111	\$ 51	\$ 60
Without a recorded allowance: <sup>(1)</sup>						
One- to four-family	\$168	\$ —	\$ 168	\$185	\$ —	\$ 185
Home equity	\$83	\$ —	\$ 83	\$84	\$ —	\$ 84
Total:						
One- to four-family	\$225	\$ 7	\$ 218	\$246	\$ 7	\$ 239
Home equity	\$178	\$ 38	\$ 140	\$195	\$ 51	\$ 144

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



Table of Contents

The following tables provide the number of loans and post-modification balances immediately after being modified by major class during the three and six months ended June 30, 2017 and 2016 (dollars in millions):

## Three Months Ended June 30, 2017

		Interest Rate Reduction	Re-age/ Extension/ Other with Interest Rate Reduction	Other <sup>(1)</sup>	Total
	Number of Loans	Interest Capitalization	Interest Capitalization	Interest Capitalization	Interest Capitalization
One- to four-family	4	\$ 1	\$ —	\$ 1	\$ 2
Home equity	53	2	1	1	4
Total	57	\$ 3	\$ 1	\$ 2	\$ 6

## Three Months Ended June 30, 2016

		Interest Rate Reduction	Re-age/ Extension/ Other with Interest Rate Reduction	Other <sup>(1)</sup>	Total
	Number of Loans	Interest Capitalization	Interest Capitalization	Interest Capitalization	Interest Capitalization
One- to four-family	7	\$ 2	\$ —	\$ 1	\$ 3
Home equity	164	3	2	6	11
Total	171	\$ 5	\$ 2	\$ 7	\$ 14

## Six Months Ended June 30, 2017

		Interest Rate Reduction	Re-age/ Extension/ Other with Interest Rate Reduction	Other <sup>(1)</sup>	Total
	Number of Loans	Interest Capitalization	Interest Capitalization	Interest Capitalization	Interest Capitalization
One- to four-family	12	\$ 3	\$ —	\$ 1	\$ 4
Home equity	214	5	1	9	15
Total	226	\$ 8	\$ 1	\$ 10	\$ 19

## Six Months Ended June 30, 2016

		Interest Rate Reduction	Re-age/ Extension/ Other with Interest Rate Reduction	Other <sup>(1)</sup>	Total
	Number of Loans	Interest Capitalization	Interest Capitalization	Interest Capitalization	Interest Capitalization
One- to four-family	21	\$ 6	\$ —	\$ 2	\$ 8
Home equity	357	5	3	18	26
Total	378	\$ 11	\$ 3	\$ 20	\$ 34

(1) Amounts represent loans whose terms were modified in a manner that did not result in an interest rate reduction, including re-aged loans, extensions, and loans with capitalized interest.

E\*TRADE | Q2 2017 10-Q 73

---

Table of Contents**NOTE 7—DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

The Company enters into derivative transactions primarily to protect against interest rate risk on the value of certain assets. Each derivative instrument is recorded on the consolidated balance sheet at fair value as a freestanding asset or liability. The following table summarizes the fair value of derivatives as reported in the consolidated balance sheet at June 30, 2017 and December 31, 2016 (dollars in millions):

	Fair Value <sup>(1)</sup>			
	Notional	Asset <sup>(2)</sup>	Liability <sup>(3)</sup>	Net <sup>(4)</sup>
June 30, 2017				
Interest rate contracts:				
Fair value hedges	\$ 6,565	\$ 90	\$ (38 )	\$ 52
Total derivatives designated as hedging instruments <sup>(5)</sup>	\$ 6,565	\$ 90	\$ (38 )	\$ 52
December 31, 2016				
Interest rate contracts:				
Fair value hedges	\$ 3,862	\$ 165	\$ (31 )	\$ 134
Total derivatives designated as hedging instruments <sup>(5)</sup>	\$ 3,862	\$ 165	\$ (31 )	\$ 134

At June 30, 2017, excludes derivative assets and liabilities of \$13 million and \$20 million, respectively, that were (1) executed through a central clearing organization and were settled by variation margin payments. See Note 4—Offsetting Assets and Liabilities for additional information.

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

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

(4) Represents net fair value of derivative instruments for disclosure purposes only.

(5) All derivatives were designated as hedging instruments at June 30, 2017 and December 31, 2016.

**Fair Value Hedges**

Fair value hedges are used to offset exposure to changes in value of certain fixed-rate assets. Fair value hedges are accounted for by recording the fair value of the derivative instrument and the fair value of the asset being hedged on the consolidated balance sheet. Changes in the fair value of both the derivative instruments and the underlying assets are recognized in the gains on securities and other, net line item in the consolidated statement of income. To the extent that the hedge is ineffective, the changes in the fair values will not offset and the difference, or hedge ineffectiveness, is reflected in the gains on securities and other, net line item in the consolidated statement of income.

Hedge accounting is discontinued for fair value hedges if a derivative instrument is sold, terminated or otherwise de-designated. If fair value hedge accounting is discontinued, the previously hedged item is no longer adjusted for changes in fair value through the consolidated statement of income and the cumulative net gain or loss on the hedged asset or liability at the time of de-designation is amortized to interest income or interest expense using the effective interest method over the expected remaining life of the hedged item. Changes in the fair value of the derivative instruments after de-designation of fair value hedge accounting are recorded in the gains on securities and other, net line item in the consolidated statement of income.

Table of Contents

The following table summarizes the effect of interest rate contracts designated as fair value hedges and related hedged items on the consolidated statement of income for the three and six months ended June 30, 2017 and 2016 (dollars in millions):

	Three Months Ended June 30,			2016		
	Hedging	Hedged	Hedge	Hedging	Hedged	Hedge
	Instrument	Item	Ineffectiveness <sup>(1)</sup>	Instrument	Item	Ineffectiveness <sup>(1)</sup>
Agency debentures	\$(17)	\$ 17	\$ —	\$(43 )	\$ 42	\$ (1 )
Agency mortgage-backed securities	(46 )	44	(2 )	(45 )	44	(1 )
Total gains (losses) included in earnings	\$(63)	\$ 61	\$ (2 )	\$(88 )	\$ 86	\$ (2 )

	Six Months Ended June 30,			2016		
	Hedging	Hedged	Hedge	Hedging	Hedged	Hedge
	Instrument	Item	Ineffectiveness <sup>(1)</sup>	Instrument	Item	Ineffectiveness <sup>(1)</sup>
Agency debentures	\$(6 )	\$ 6	\$ —	\$(90 )	\$ 88	\$ (2 )
Agency mortgage-backed securities	(33 )	30	(3 )	(114 )	112	(2 )
Total gains (losses) included in earnings	\$(39)	\$ 36	\$ (3 )	\$(204)	\$ 200	\$ (4 )

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

**NOTE 8—DEPOSITS**

Deposits are summarized as follows (dollars in millions):

	Amount		Weighted-Average Rate			
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
Sweep deposits	\$34,937	\$ 26,362	0.01	%	0.01	%
Savings deposits	3,078	3,185	0.01	%	0.01	%
Other deposits <sup>(1)(2)</sup>	2,057	2,135	0.03	%	0.03	%
Total deposits	\$40,072	\$ 31,682	0.01	%	0.01	%

(1) Includes checking deposits, money market and time deposits.

(2) As of June 30, 2017 and December 31, 2016, the Company had \$184 million and \$177 million in non-interest bearing deposits, respectively.

Table of Contents

## NOTE 9—OTHER BORROWINGS

Other borrowings at June 30, 2017 and December 31, 2016 are summarized as follows (dollars in millions):

	June 30, 2017	December 31, 2016
Repurchase agreements	\$400	\$ —
FHLB advances	200	—
Total repurchase agreements and FHLB advances	600	—
Trust preferred securities <sup>(1)</sup>	409	409
Total other borrowings	\$1,009	\$ 409

(1) Trust preferred securities begin maturing in 2031.

External Lines of Credit maintained at E\*TRADE Securities

E\*TRADE Securities' external liquidity lines total approximately \$1.1 billion as of June 30, 2017 and include the following:

• A 364-day, \$450 million senior unsecured committed revolving credit facility with a syndicate of banks, with a maturity date of June 2018

• Secured committed lines of credit with two unaffiliated banks, aggregating to \$175 million, with a maturity date of June 2018

• Unsecured uncommitted lines of credit with two unaffiliated banks aggregating to \$75 million, of which \$50 million has a maturity date of June 2018 and the remaining line has no maturity date

• Secured uncommitted lines of credit with several unaffiliated banks aggregating to \$375 million with no maturity date

The revolving credit facility contains maintenance covenants related to E\*TRADE Securities' minimum consolidated tangible net worth and regulatory net capital ratio. There were no outstanding balances for these lines at June 30, 2017.

Table of Contents

## NOTE 10—CORPORATE DEBT

Corporate debt at June 30, 2017 and December 31, 2016 is outlined in the following table (dollars in millions):

	Face Value	Discount	Net
June 30, 2017			
Interest-bearing notes:			
5 <sup>3</sup> / <sub>8</sub> % Notes, due 2022	\$540	\$ (4 )	\$536
4 <sup>5</sup> / <sub>8</sub> % Notes, due 2023	460	(4 )	456
Total corporate debt	\$1,000	\$ (8 )	\$992
December 31, 2016			
Interest-bearing notes:			
5 <sup>3</sup> / <sub>8</sub> % Notes, due 2022		\$540	\$(5) \$535
4 <sup>5</sup> / <sub>8</sub> % Notes, due 2023		460	(4 ) 456
Total interest-bearing notes		1,000	(9 ) 991
Non-interest-bearing debt:			
0% Convertible debentures, due 2019	3	—	3
Total corporate debt		\$1,003	\$(9) \$994

## Conversions of Convertible Debentures

During the six months ended June 30, 2017, \$3 million of the Company's convertible debentures were converted into 0.3 million shares of common stock.

## Credit Facility

On June 23, 2017, we entered into an unsecured committed revolving credit facility with certain lenders, which replaced our previous secured committed revolving credit facility entered into in November 2014 and increased our total borrowing capacity under the facility to \$300 million. The Company has the ability to borrow against the credit facility for working capital and general corporate purposes. The unsecured committed revolving credit facility will mature on June 23, 2020. At June 30, 2017, there was no outstanding balance under this revolving credit facility.

Table of Contents

## NOTE 11—SHAREHOLDERS' EQUITY

The following tables present after-tax changes in each component of accumulated other comprehensive income (loss) for the six months ended June 30, 2017 and 2016 (dollars in millions):

	Available-for-Sale Securities	Foreign Currency Translation	Total
Balance, December 31, 2016	\$ (139 )	\$ 2	\$(137)
Other comprehensive income before reclassifications	46	—	46
Amounts reclassified from accumulated other comprehensive loss	(5 )	(2 )	(7 )
Net change	41	(2 )	39
Balance, March 31, 2017	\$ (98 )	\$ —	\$(98 )
Other comprehensive income before reclassifications	42	—	42
Amounts reclassified from accumulated other comprehensive loss	(6 )	—	(6 )
Net change	36	—	36
Balance, June 30, 2017	\$ (62 )	\$ —	\$(62 )
	Available-for-Sale Securities	Foreign Currency Translation	Total
Balance, December 31, 2015	\$ (101 )	\$ 2	\$(99)
Other comprehensive income before reclassifications	94	—	94
Amounts reclassified from accumulated other comprehensive loss	(9 )	—	(9 )
Net change	85	—	85
Balance, March 31, 2016	\$ (16 )	\$ 2	\$(14)
Other comprehensive income before reclassifications	69	—	69
Amounts reclassified from accumulated other comprehensive income	(9 )	—	(9 )
Net change	60	—	60
Balance, June 30, 2016	\$ 44	\$ 2	\$46

Table of Contents

The following table presents other comprehensive income activity and the related tax effect for the three and six months ended June 30, 2017 and 2016 (dollars in millions):

	Three Months Ended June 30,					
	2017			2016		
	Before Tax	After Tax	Effect	Before Tax	After Tax	Effect
Other comprehensive income						
Available-for-sale securities:						
Unrealized gains, net	\$68	\$ (26 )		\$42	\$112	\$ (43 )
Reclassification into earnings, net	(10 )	4		(6 )	(14 )	5
Net change from available-for-sale securities	58	(22 )		36	98	(38 )
Other comprehensive income	\$58	\$ (22 )		\$36	\$98	\$ (38 )

	Six Months Ended June 30,					
	2017			2016		
	Before Tax	After Tax	Effect	Before Tax	After Tax	Effect
Other comprehensive income						
Available-for-sale securities:						
Unrealized gains, net	\$144	\$ (56 )		\$88	\$264	\$ (101 )
Reclassification into earnings, net	(18 )	7		(11 )	(29 )	11
Net change from available-for-sale securities	126	(49 )		77	235	(90 )
Reclassification of foreign currency translation gains	(2 )	—		(2 )	—	—
Other comprehensive income	\$124	\$ (49 )		\$75	\$235	\$ (90 )

The following table presents the consolidated statement of income line items impacted by reclassifications out of accumulated other comprehensive income (loss) for the three and six months ended June 30, 2017 and 2016 (dollars in millions):

Accumulated Other Comprehensive Income (Loss) Components	Amounts Reclassified from Accumulated Other Comprehensive Income (Loss)				Affected Line Items in the Consolidated Statement of Income
	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016		
	2017	2016	2017	2016	
Available-for-sale securities:					
	\$10	\$14	\$18	\$29	Gains on securities and other, net
	(4 )	(5 )	(7 )	(11 )	Income tax expense
	\$6	\$9	\$11	\$18	Reclassification into earnings, net
Foreign currency translation:					
	\$—	\$—	\$2	\$—	Other non-interest expenses
	\$—	\$—	\$2	\$—	Reclassification into earnings, net
Preferred Stock Dividends					

On February 2, 2017, the Company's Board of Directors declared a dividend of \$32.64 per share, or \$13 million, to holders of record of the Series A Preferred stock as of February 28, 2017. The dividend was paid



E\*TRADE | Q2 2017 10-Q 79

---

Table of Contents

on March 15, 2017. On August 2, 2017, the Company's Board of Directors declared a dividend of \$29.38 per share, or \$12 million, to holders of record of the Series A Preferred stock as of August 31, 2017. The dividend will be paid on September 15, 2017.

**Share Repurchases**

On July 20, 2017, the Company announced that its Board of Directors authorized the repurchase of up to \$1 billion of shares of its common stock. The timing and exact amount of any common stock repurchases will depend on various factors, including market conditions and the Company's capital position.

**NOTE 12—EARNINGS PER SHARE**

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

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
Basic:				
Net income	\$193	\$ 133	\$338	\$ 286
Preferred stock dividends	—	—	13	—
Net income available to common shareholders	\$193	\$ 133	\$325	\$ 286
Basic weighted-average shares outstanding (in thousands)	275,410	277,013	275,162	281,141
Basic earnings per common share	\$0.70	\$ 0.48	\$1.18	\$ 1.02
Diluted:				
Net income	\$193	\$ 133	\$338	\$ 286
Preferred stock dividends	—	—	13	—
Net income available to common shareholders	\$193	\$ 133	\$325	\$ 286
Basic weighted-average shares outstanding (in thousands)	275,410	277,013	275,162	281,141
Effect of dilutive securities:				
Weighted-average restricted stock and options issued to employees (in thousands)	843	646	1,048	828
Weighted-average convertible debentures (in thousands)	19	319	155	457
Diluted weighted-average shares outstanding (in thousands)	276,272	277,978	276,370	282,426
Diluted earnings per common share	\$0.70	\$ 0.48	\$1.17	\$ 1.01

For both the three and six months ended June 30, 2017 and 2016, the Company excluded less than 0.1 million of stock options and restricted stock awards and units from the calculations of diluted earnings per share as the effect would have been anti-dilutive.

Table of Contents**NOTE 13—REGULATORY REQUIREMENTS****Broker-Dealer and FCM Capital Requirements**

The Company's U.S. broker-dealer subsidiaries are subject to the Uniform Net Capital Rule under the Securities Exchange Act of 1934 administered by the SEC and FINRA, which requires the maintenance of minimum net capital. The minimum net capital requirements can be met under either the Aggregate Indebtedness method or the Alternative method. Under the Aggregate Indebtedness method, a broker-dealer is required to maintain minimum net capital of the greater of 6 <sup>2</sup>/<sub>3</sub>% of its aggregate indebtedness, as defined, or a minimum dollar amount. Under the Alternative method, a broker-dealer is required to maintain net capital equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions. The method used depends on the individual U.S. broker-dealer subsidiary. As FCMs, the Company's U.S. broker-dealer subsidiaries are also subject to CFTC net capital requirements, including the maintenance of adjusted net capital equal to or in excess of the greater of (1) \$1,000,000 (2) the FCM's risk-based capital requirement, computed as 8% of the total risk margin requirements for all positions carried in customer and non-customer accounts, (3) the amount of adjusted net capital required by the NFA or (4) the amount of net capital required by the SEC's net capital rule. The Company's international broker-dealer subsidiary is subject to capital requirements determined by its respective regulator.

At June 30, 2017 and December 31, 2016, all of the Company's broker-dealer subsidiaries met minimum net capital requirements. The tables below summarize the minimum capital requirements and excess capital for the Company's broker-dealer subsidiaries at June 30, 2017 and December 31, 2016 (dollars in millions):

	Required Net Capital	Net Capital	Excess Net Capital
June 30, 2017:			
E*TRADE Securities <sup>(1)(2)</sup>	\$ 181	\$ 1,062	\$ 881
OptionsHouse <sup>(3)</sup>	1	37	36
Other broker-dealer	—	23	23
Total	\$ 182	\$ 1,122	\$ 940
December 31, 2016:			
E*TRADE Securities <sup>(1)</sup>	\$ 158	\$ 969	\$ 811
OptionsHouse <sup>(3)</sup>	1	22	21
Other broker-dealer	—	21	21
Total	\$ 159	\$ 1,012	\$ 853

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

(2) E\*TRADE Securities paid dividends of \$120 million to the parent company during the six months ended June 30, 2017.

(3) Elected to use the Aggregate Indebtedness method to compute net capital; however, as OptionsHouse is an FCM, the prescribed fixed-dollar minimum capital requirement is \$1 million.

**Bank Capital Requirements**

E\*TRADE Financial and E\*TRADE Bank are 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 Financial's and E\*TRADE Bank's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, E\*TRADE Financial and E\*TRADE Bank must meet specific capital guidelines that involve quantitative measures of 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 the non-objection, or in certain cases the approval, of its regulators, and any loans by E\*TRADE Bank to the parent

E\*TRADE | Q2 2017 10-Q 81

---

Table of Contents

company and its other non-bank subsidiaries are subject to various quantitative, arm's length, collateralization and other requirements. E\*TRADE Financial's and E\*TRADE Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require E\*TRADE Financial and E\*TRADE Bank to meet minimum Tier 1 leverage, common equity Tier 1 capital, Tier 1 risk-based capital and total risk-based capital ratios. Events beyond management's control, such as deterioration in credit markets, could adversely affect future earnings and E\*TRADE Financial's and E\*TRADE Bank's ability to meet future capital requirements. E\*TRADE Financial and E\*TRADE Bank were categorized as "well capitalized" under the regulatory framework for prompt corrective action for the periods presented in the table below (dollars in millions):

	June 30, 2017			December 31, 2016		
	Actual	Well Capitalized Minimum Capital		Actual	Well Capitalized Minimum Capital	
		Amount	Ratio		Amount	Ratio
E*TRADE Financial <sup>(1)</sup>						
Tier 1 leverage	\$4,045	7.5 %	\$2,711 5.0 %	\$1,334	\$3,610 7.8 %	\$2,316 5.0 %
Common equity Tier 1 capital	\$3,775	35.0 %	\$701 6.5 %	\$3,074	\$3,483 37.0 %	\$612 6.5 %
Tier 1 risk-based capital	\$4,045	37.5 %	\$862 8.0 %	\$3,183	\$3,610 38.3 %	\$754 8.0 %
Total risk-based capital	\$4,575	42.4 %	\$1,078 10.0 %	\$3,497	\$4,148 44.0 %	\$942 10.0 %
	June 30, 2017			December 31, 2016		
	Actual	Well Capitalized Minimum Capital		Actual	Well Capitalized Minimum Capital	
		Amount	Ratio		Amount	Ratio
E*TRADE Bank <sup>(1)</sup>						
Tier 1 leverage	\$3,453	8.0 %	\$2,172 5.0 %	\$1,281	\$3,132 8.8 %	\$1,786 5.0 %
Common equity Tier 1 capital	\$3,453	35.1 %	\$640 6.5 %	\$2,813	\$3,132 38.3 %	\$532 6.5 %
Tier 1 risk-based capital	\$3,453	35.1 %	\$787 8.0 %	\$2,666	\$3,132 38.3 %	\$655 8.0 %
Total risk-based capital	\$3,569	36.3 %	\$984 10.0 %	\$2,585	\$3,237 39.5 %	\$819 10.0 %

The Basel III final rule introduces a capital conservation buffer that limits a banking organization's ability to make capital distributions and discretionary bonus payments to executive officers if a banking organization fails to maintain a Common Equity Tier 1 capital conservation buffer of more than 2.5%, on a fully phased-in basis, of total risk-weighted assets above each of the following minimum risk-based capital ratio requirements: Common Equity Tier 1 capital (4.5%), Tier 1 (6.0%), and total risk-based capital (8.0%). This requirement was effective beginning on January 1, 2016, and will be fully phased-in by 2019. Certain new regulatory deductions and adjustments are subject to a phase-in period over a four year period, beginning at 40% in 2015 and fully implemented at 100% in 2018.

Table of Contents

**NOTE 14—COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS**

The Company reviews its lawsuits, regulatory inquiries and other legal proceedings on an ongoing basis and provides disclosure and records loss contingencies in accordance with the loss contingencies accounting guidance. The Company establishes an accrual for losses at management's best estimate when it assesses that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. The Company monitors these matters for developments that would affect the likelihood of a loss and the accrued amount, if any, and adjusts the amount as appropriate.

**Litigation Matters**

On October 27, 2000, Ajaxo, Inc. (Ajaxo) filed a complaint in the Superior Court for the State of California, County of Santa Clara. Ajaxo sought damages and certain non-monetary relief for the Company's alleged breach of a non-disclosure agreement with Ajaxo pertaining to certain wireless technology that Ajaxo offered the Company as well as damages and other relief against the Company for their alleged misappropriation of Ajaxo's trade secrets. Following a jury trial, a judgment was entered in 2003 in favor of Ajaxo against the Company for \$1 million for breach of the Ajaxo non-disclosure agreement. Although the jury found in favor of Ajaxo on its claim against the Company for misappropriation of trade secrets, the trial court subsequently denied Ajaxo's requests for additional damages and relief. On December 21, 2005, the California Court of Appeal affirmed the above-described award against the Company for breach of the nondisclosure agreement but remanded the case to the trial court for the limited purpose of determining what, if any, additional damages Ajaxo may be entitled to as a result of the jury's previous finding in favor of Ajaxo on its claim against the Company for misappropriation of trade secrets. Although the Company paid Ajaxo the full amount due on the above-described judgment, the case was remanded back to the trial court, and on May 30, 2008, a jury returned a verdict in favor of the Company denying all claims raised and demands for damages against the Company. Following the trial court's entry of judgment in favor of the Company on September 5, 2008, Ajaxo filed post-trial motions for vacating this entry of judgment and requesting a new trial. The trial court denied these motions. On December 2, 2008, Ajaxo filed a notice of appeal with the Court of Appeal of the State of California for the Sixth District. On August 30, 2010, the Court of Appeal affirmed the trial court's verdict in part and reversed the verdict in part, remanding the case. The Company petitioned the Supreme Court of California for review of the Court of Appeal decision. On December 16, 2010, the California Supreme Court denied the Company's petition for review and remanded for further proceedings to the trial court. The testimonial phase of the third trial in this matter concluded on June 12, 2012. By order dated May 28, 2014, the Court determined to conduct a second phase of this bench trial to allow Ajaxo to attempt to prove entitlement to additional royalties. Hearings in phase two of the trial concluded January 8, 2015. In a Judgment and Statement of Decision filed September 16, 2015, the Court denied all claims for royalties by Ajaxo. Ajaxo's post-trial motions were denied. Ajaxo has appealed to the Court of Appeal, Sixth District. Briefing of this appeal is expected to continue into August 2017. The Company will continue to defend itself vigorously.

On May 16, 2011, Droplets Inc., the holder of two patents pertaining to user interface servers, filed a complaint in the U.S. District Court for the Eastern District of Texas against E\*TRADE Financial Corporation, E\*TRADE Securities, E\*TRADE Bank and multiple other unaffiliated financial services firms. Plaintiff contends that the defendants engaged in patent infringement under federal law. Plaintiff seeks unspecified damages and an injunction against future infringements, plus royalties, costs, interest and attorneys' fees. On March 28, 2012, a change of venue was granted and the case was transferred to the United States District Court for the Southern District of New York. The Company's motion for summary judgment on the grounds of non-infringement was granted by the U.S. District Court in a Decision and Order dated March 9, 2015. All remaining claims are stayed pending resolution of issues on Droplet's remaining patents under review by the Patent Trial and Appeal Board (PTAB). On July 6, 2015, the PTAB instituted an inter partes review of plaintiff's '115 patent. A hearing on the inter partes review was conducted on March 14, 2016. On June 23, 2016, the PTAB deemed Droplets' putative '115 patent to be "unpatentable." In a separate proceeding, the PTAB has also separately deemed Droplets' putative '838



Table of Contents

patent to be “unpatentable.” Droplets has appealed to the Circuit Court of Appeals for the District of Columbia. The opening brief was filed on December 23, 2016 and briefing was completed on July 24, 2017. Oral argument has not yet been scheduled. The Company will continue to defend itself vigorously in this matter.

On April 30, 2013, a putative class action was filed by John Scranton, on behalf of himself and a class of persons similarly situated, against E\*TRADE Financial Corporation and E\*TRADE Securities in the Superior Court of California, County of Santa Clara, pursuant to the California procedures for a private Attorney General action. The complaint alleged that the Company misrepresented through its website that it would always automatically exercise options that were in-the-money by \$0.01 or more on expiration date. The plaintiffs allege violations of the California Unfair Competition Law, the California Consumer Remedies Act, fraud, misrepresentation, negligent misrepresentation and breach of fiduciary duty and plaintiffs seek unspecified damages. The case has been deemed complex within the meaning of the California Rules of Court, and a case management conference was held on September 13, 2013. The Company’s demurrer and motion to strike the complaint were granted by order dated December 20, 2013. The Court granted leave to amend the complaint. A second amended complaint was filed on January 31, 2014. On March 11, 2014, the Company moved to strike and for a demurrer to the second amended complaint. On October 20, 2014, the Court sustained the Company’s demurrer, dismissing four counts of the second amended complaint with prejudice and two counts without prejudice. The plaintiffs filed a third amended complaint on November 10, 2014. The Company filed a third demurrer and motion to strike on December 12, 2014. By order dated March 18, 2015, the Superior Court entered a final order sustaining the Company’s demurrer on all remaining claims with prejudice. Final judgment was entered in the Company’s favor on April 8, 2015. The plaintiff filed a Notice of Appeal on April 27, 2015. The briefing is complete but oral argument has not yet been scheduled. The Company will continue to defend itself vigorously in this matter.

On March 26, 2015, a putative class action was filed in the U.S. District Court for the Northern District of California by Ty Rayner, on behalf of himself and all others similarly situated, naming E\*TRADE Financial Corporation and E\*TRADE Securities as defendants. The complaint alleges that E\*TRADE breached a fiduciary duty and unjustly enriched itself in connection with the routing of its customers’ orders to various market-makers and exchanges. Plaintiff seeks unspecified damages, declaratory relief, restitution, disgorgement of payments received by the Company, and attorneys’ fees. On July 23, 2016, a putative class action was filed in the U.S. District Court for the Southern District of New York by Craig L. Schwab, on behalf of himself and others similarly situated, naming E\*TRADE Financial Corporation, E\*TRADE Securities LLC, and former Company executives as defendants. The complaint alleges that E\*TRADE violated federal securities laws in connection with the routing of its customers’ orders to various market-makers and exchanges. Plaintiff seeks unspecified damages, declaratory relief, restitution, disgorgement of payments received by the Company, and attorneys’ fees. By stipulation, the Rayner case has been consolidated with the Schwab case and both matters are now venued in the Southern District of New York. E\*TRADE has moved to dismiss the complaint in Rayner. On April 2, 2017, the District Court dismissed the complaint in Rayner. On May 5, 2017, plaintiffs in Rayner appealed. E\*TRADE moved to dismiss the Schwab case on January 11, 2017; and in response, the Schwab plaintiffs submitted an amended Complaint on February 10, 2017. The amended Schwab complaint asserts only two claims: violation of Section 10(b) of the Exchange Act by E\*TRADE Securities LLC and E\*TRADE Financial Corporation; and violation of Section 20(a) of the Exchange Act by E\*TRADE’s two most recent chief executive officers. On July 10, the Court dismissed the Schwab claims without prejudice. The Company will continue to defend itself vigorously in these matters.



## Table of Contents

In addition to the matters described above, the Company is subject to various legal proceedings and claims that arise in the normal course of business. In each pending matter, the Company contests liability or the amount of claimed damages. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages, or where investigation or discovery have yet to be completed, the Company is unable to estimate a range of reasonably possible losses on its remaining outstanding legal proceedings; however, the Company believes any losses, both individually or in the aggregate, would not be reasonably likely to have a material adverse effect on the consolidated financial condition or results of operations of the Company.

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

### Regulatory Matters

The securities, futures, foreign currency and banking industries are subject to extensive regulation under federal, state and applicable international laws. From time to time, the Company has been threatened with or named as a defendant in lawsuits, arbitrations and administrative claims involving securities, banking and other matters. The Company is also subject to periodic regulatory examinations and inspections. Compliance and trading problems that are reported to regulators, such as the SEC, FINRA, NASDAQ, CFTC, NFA, FDIC, Federal Reserve Bank of Richmond, OCC, or the Consumer Financial Protection Bureau (CFPB) 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.

### Insurance

The Company maintains insurance coverage that management believes is reasonable and prudent. The principal insurance coverage it maintains covers commercial general liability; property damage; hardware/software damage; cyber liability; directors and officers; employment practices liability; certain criminal acts against the Company; and errors and omissions. The Company believes that such insurance coverage is adequate for the purpose of its business. The Company's ability to maintain this level of insurance coverage in the future, however, is subject to the availability of affordable insurance in the marketplace.

### Commitments

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

The Company's equity method, cost method and other investments are generally limited liability investments in partnerships, companies and other similar entities, including tax credit partnerships and community development entities, which are not required to be consolidated. The Company had \$84 million in unfunded commitments with respect to these investments at June 30, 2017.

At June 30, 2017, the Company had approximately \$22 million of certificates of deposit scheduled to mature in less than one year and approximately \$5 million of unfunded commitments to extend credit.

Table of Contents

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 TRUPs 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 TRUPs 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 TRUPs, 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 June 30, 2017, management estimated that the maximum potential liability under this arrangement, including the current carrying value of the trusts, was equal to approximately \$416 million or the total face value of these securities plus accrued interest payable, which may be unpaid at the termination of the trust arrangement.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Based on an evaluation under the supervision and with the participation of our management, our Chief Executive Officer and our Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), were effective as of the end of the period covered by this report to provide reasonable assurance that information

(a) required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) There were no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2017, identified in connection with management's evaluation required by paragraph (d) of Exchange Act Rules 13a-15 and 15d-15, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

## PART II

## ITEM 1. LEGAL PROCEEDINGS

Information in response to this item can be found under the heading Legal Matters in Note 14—Commitments, Contingencies and Other Regulatory Matters to Part I. Item 1. Condensed Consolidated Financial Statements (Unaudited) in this Quarterly Report and is incorporated by reference into this item.

## ITEM 1A. RISK FACTORS

There have been no material changes in the Company's risk factors from those disclosed in its Annual Report on Form 10-K for the year ended December 31, 2016.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

## Issuer Purchases of Equity Securities

The table below shows the timing and impact of our share repurchase program, if applicable, and the shares withheld from employees to satisfy tax withholding obligations during the three months ended June 30, 2017 (dollars in millions, except share data and per share amounts):

Period	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid per Share <sup>(2)</sup>	Total Number of Shares Purchased as Part of the Publicly Announced Plan <sup>(3)</sup>	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plan <sup>(3)</sup>
April 1, 2017 - April 30, 2017	2,428	\$ 34.08	—	\$ —
May 1, 2017 - May 31, 2017	1,412	\$ 35.02	—	\$ —
June 1, 2017 - June 30, 2017	6,847	\$ 35.14	—	\$ —
Total	10,687	\$ 34.88	—	

(1) The 10,687 shares purchased during the three months ended June 30, 2017 were withheld from employees to satisfy tax withholding obligations associated with restricted shares.

(2) Excludes commission paid, if any.

On July 20, 2017, the Company announced that its Board of Directors authorized the repurchase of up to \$1 billion (3) of shares of its common stock. The timing and exact amount of any common stock repurchases will depend on various factors, including market conditions and the Company's capital position.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description
-------------------	-------------

3.1	Amended and Restated Bylaws of E*TRADE Financial Corporation, effective as of June 14, 2017 (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed on June 20, 2017).
-----	--

*31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
-------	---

*31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
-------	---

*32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 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  
herewith.

Table of Contents

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: August 3, 2017

E\*TRADE Financial Corporation  
(Registrant)

By /S/ KARL A. ROESSNER  
Karl A. Roessner  
Chief Executive Officer  
(Principal Executive Officer)

By /S/ MICHAEL A. PIZZI  
Michael A. Pizzi  
Chief Financial Officer  
(Principal Financial Officer)

By /S/ BRENT B. SIMONICH  
Brent B. Simonich  
Corporate Controller  
(Principal Accounting Officer)

E\*TRADE | Q2 2017 10-Q 90