

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 March 31, 2018

Commission File Number 1-11921

**E\*TRADE Financial Corporation**

(Exact Name of Registrant as Specified in its Charter)

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**94-2844166**

(I.R.S. Employer  
Identification Number)

**11 Times Square, 32<sup>nd</sup> Floor, New York, New York 10036**

(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 ☒

Accelerated filer

☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company

☐

Emerging growth company ☐

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 April 30, 2018, there were 263,909,776 shares of common stock outstanding.

**E\*TRADE FINANCIAL CORPORATION**  
**FORM 10-Q QUARTERLY REPORT**  
**For the Quarter Ended March 31, 2018**  
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***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.***

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# PART I

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## 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 proposed transaction with Capital One and its benefits and timing,
- our capital plan initiatives and expected balance sheet size,
- the payment of dividends from our subsidiaries to our parent company,
- the management of our legacy mortgage and consumer loan portfolio,
- our ability to utilize deferred tax assets, the expected implementation and applicability of government regulation and our ability to comply with these regulations,
- our ability to maintain required regulatory capital ratios,
- continued repurchases of our common stock, payment of dividends on our preferred stock,
- our ability to meet upcoming debt obligations,
- the integration and related restructuring costs of past and any future acquisitions,
- the expected outcome of existing or new litigation,
- our ability to execute our business plans and manage risk,
- the potential decline of fees and service charges,
- future sources of revenue, expense and liquidity, 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:

- the closing of the proposed transaction with Capital One Financial Corporation may not occur or may be delayed and that the actual aggregate consideration paid in connection with the proposed transaction is still subject to final determination,
- changes in business, economic or political condition,
- performance, volume and volatility in the equity and capital markets,
- changes in interest rates or interest rate volatility,
- customer demand for financial products and services,
- our ability to continue to compete effectively and respond to aggressive price competition within our industry,
- cyber security threats, potential system disruptions and other security breaches or incidents,
- our ability to participate in consolidation opportunities in our industry, to complete consolidation transactions and to realize synergies or implement integration plans,
- our ability to service our corporate debt and, if necessary, to raise additional capital,
- changes in government regulation or actions by our regulators, including those that may result from the implementation and enforcement of regulatory reform legislation,
- our ability to move capital to our parent company from our subsidiaries,

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- adverse developments in litigation,
- our ability to manage our balance sheet growth, and
- the timing, duration and costs associated with our stock repurchase program.

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. Investors should also consider the risks and uncertainties described elsewhere in this report, including under *Part II. Item 1A. Risk Factors* and *Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations* and *Part I. Item 1A. Risk Factors* of our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission (SEC), which are incorporated herein by reference. The forward-looking statements contained in this report reflect our expectations only as of the date of this report. Investors should not place undue reliance on forward-looking statements, as we do not undertake to update or revise forward-looking statements, except as required by law.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)

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, 2017.

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### OVERVIEW

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#### Company Overview

E\*TRADE is a financial services company that provides online brokerage and related products and services primarily to individual retail investors. Our business is organized into three product areas: Trading, Investing and Corporate Services. Additionally, we offer banking and cash management capabilities, including deposit accounts insured by the Federal Deposit Insurance Corporation (FDIC), which are fully integrated into customer brokerage accounts.

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.

We operate directly and through several subsidiaries, many of which are overseen by governmental and self-regulatory organizations. Our most important subsidiaries are described below:

- E\*TRADE Securities LLC (E\*TRADE Securities) is a registered broker-dealer that clears and settles customer securities transactions.
- E\*TRADE Bank is a federally chartered savings bank that provides FDIC insurance on qualifying amounts of customer deposits and provides other banking and cash management capabilities.
- E\*TRADE Savings Bank, a subsidiary of E\*TRADE Bank, is a federally chartered savings bank that provides FDIC insurance on qualifying amounts of customer deposits, and now also provides custody solutions to Registered Investment Advisers (RIAs) as the acquisition of Trust Company of America (TCA) was completed in April 2018.
- E\*TRADE Financial Corporate Services is a provider of software and services for managing equity compensation plans to our corporate clients. The Corporate Services channel is an important driver of brokerage account and asset growth.
- E\*TRADE Futures LLC (E\*TRADE Futures) is a registered non-clearing Futures Commission Merchant (FCM) that provides clearing and settlement services for customer futures transactions.
- E\*TRADE Capital Management, LLC (E\*TRADE Capital Management) is a registered investment adviser that provides investment advisory services for our customers.

## Strategy

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

### ***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 continue growing our customer base while deepening engagement with our existing customers.

- ***Capitalize on value of corporate services channel***

Our corporate services channel is a strategically important driver of brokerage account and asset growth. 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.

### ***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. Meanwhile, we continue to manage down the size and risk associated with our legacy mortgage and consumer loan portfolio.

- ***Put capital to work for shareholders***

As we continue to deliver on our capital plan initiatives, we are focused on generating and effectively deploying excess capital, including through our share repurchase program, 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 incurred on interest-bearing liabilities, including deposits, customer payables, corporate debt and other borrowings. Net interest income is also earned on our legacy mortgage and consumer 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, mutual fund service fees 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.

## Significant Events in the First Quarter of 2018

### ***Announced acquisition of brokerage accounts from Capital One***

In January 2018, we announced an agreement to acquire approximately one million retail brokerage accounts with \$18 billion in customer assets from Capital One for a cash purchase price of up to \$170 million. We intend to fund this transaction with existing cash. The acquisition is expected to close by the third quarter of 2018, subject to customary closing conditions and regulatory approvals.

### ***Completed Trust Company of America acquisition***

On April 9, 2018, we completed the acquisition of TCA for a cash purchase price of \$275 million. The acquisition is expected to benefit the Company as the RIA portion of our industry is growing and the Company expects to leverage the E\*TRADE brand to accelerate growth. The Company also expects this acquisition to help bolster the Company's ability to retain customers in need of specialized customer service engagement. For additional information, see *Note 15—Subsequent Event*.

### ***Repurchased 2.7 million shares of our common stock***

We continued to execute on our share repurchase program, under which the Board of Directors has authorized the repurchase of up to \$1 billion of shares of our common stock. During the three months ended March 31, 2018, the Company repurchased 2.7 million shares of common stock at an average price of \$52.12 for a total of \$140 million. As of March 31, 2018, we have repurchased 11.2 million shares of common stock at an average price of \$44.91 for a total of \$502 million since we began repurchasing shares under this authorization in the third quarter of 2017. As of March 31, 2018, \$498 million remained available for additional repurchases. As of April 30, 2018, we have subsequently repurchased an additional 0.9 million shares of common stock at an average price of \$60.01.

### ***Tier 1 leverage ratio threshold reduced for E\*TRADE Bank***

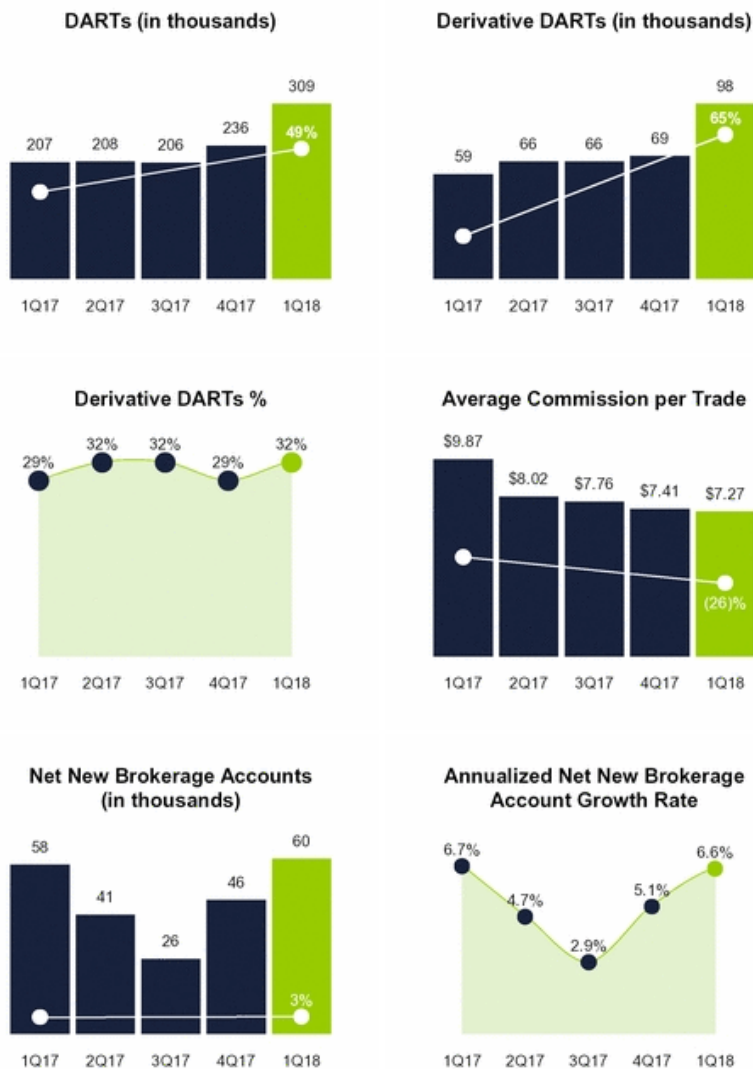
Beginning January 2018, E\*TRADE Bank's Tier 1 leverage ratio threshold was reduced to 7.0% from the previous threshold of 7.5%.



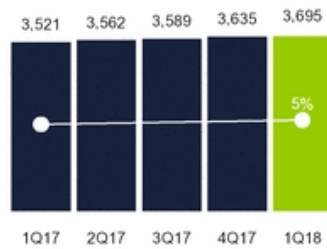
## Key Performance Metrics

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 March 31, 2018 from the same period in 2017.

### Customer Activity Metrics:



**End of Period Brokerage Accounts  
(in thousands)**



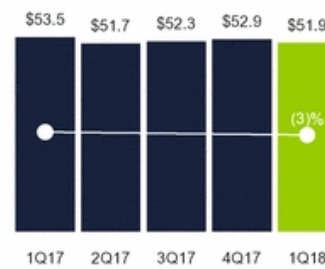
**Customer Margin Balances (\$B)**



**Customer Assets (\$B)**



**Brokerage Related Cash (\$B)**



**Net New Brokerage Assets (\$B)**



**Annualized Net New Brokerage  
Asset Growth Rate**





**Daily Average Revenue Trades (DARTs)** is the predominant driver of commissions revenue from our customers. DARTs were 309,469 and 207,221 for the three months ended March 31, 2018 and 2017, respectively.

**Derivative DARTs**, a key driver of commissions revenue, is the daily average number of options and futures trades, and **Derivative DARTs percentage** is the mix of options and futures as a component of total DARTs. Derivative DARTs were 97,658 and 59,078 for the three months ended March 31, 2018 and 2017, respectively, and Derivative DARTs represented 32% and 29%, respectively, of total DARTs.

**Average commission per trade** is an indicator of changes in our customer mix, product mix and/or product pricing. Average commission per trade was \$7.27 and \$9.87 for the three months ended March 31, 2018 and 2017, respectively. Average commission per trade for the three months ended March 31, 2018 was impacted by our reduced commission rates for equity and options trades effective March 13, 2017, which were as follows:

- Stock, options and ETF trade commissions reduced to \$6.95 from \$9.99
- For active traders, commissions reduced to \$4.95 from \$7.99 and options charges reduced to \$0.50 per contract from \$0.75; trades required for active trader tier reduced to 30 per quarter from 150

**End of period brokerage accounts** and **net new brokerage accounts** are indicators of our ability to attract and retain brokerage customers. End of period brokerage accounts were 3.7 million and 3.5 million at March 31, 2018 and 2017, respectively. Net new brokerage accounts were 59,685 and 58,215 for the three months ended March 31, 2018 and 2017, respectively. During the three months ended March 31, 2018 and 2017, our annualized net new brokerage account growth rate was 6.6% and 6.7%, respectively.

**Customer margin balances** represents credit extended to customers to finance their purchases of securities by borrowing against securities they own and is a key driver of net interest income. Customer margin balances were \$10.5 billion and \$7.3 billion at March 31, 2018 and 2017, respectively.

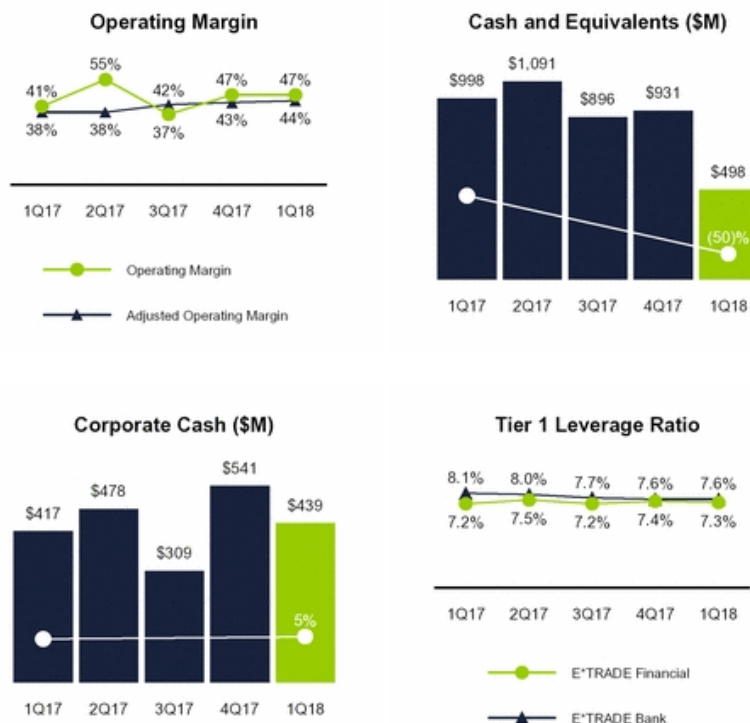
**Customer assets** is an indicator of the value of our relationship with the customer. An increase generally indicates that the use of our products and services by existing and new customers is expanding. Changes in this metric are also driven by changes in the valuations of our customers' underlying securities. Customer assets were \$392.8 billion and \$335.7 billion at March 31, 2018 and 2017, respectively.

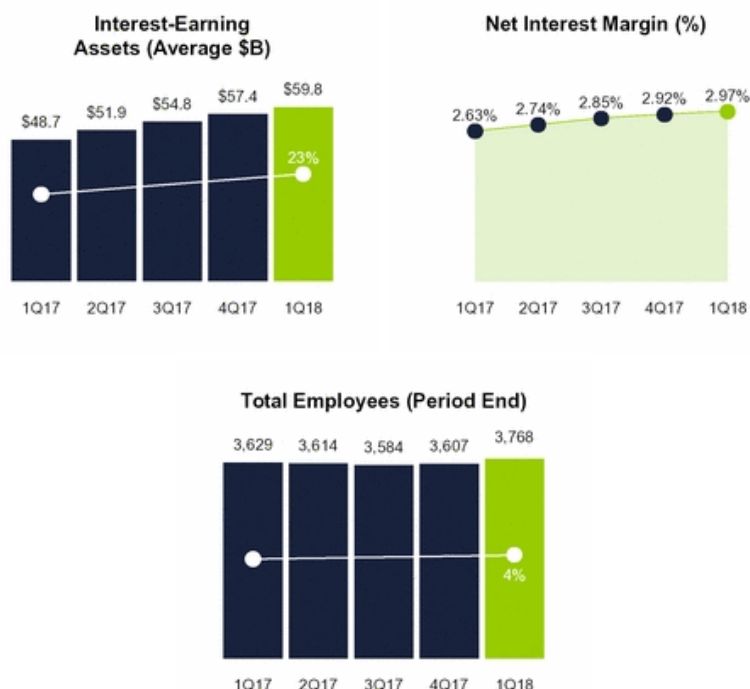
**Brokerage related cash** is an indicator of the level of engagement with our brokerage customers and is a key driver of net interest income as well as fees and service charges revenue, which includes fees earned on customer cash held by third parties. Brokerage related cash was \$51.9 billion and \$53.5 billion at March 31, 2018 and 2017, 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 \$5.3 billion and \$4.2 billion for the three months ended March 31, 2018 and 2017, respectively. During the three months ended March 31, 2018 and 2017, our annualized net new brokerage asset growth rate was 6.3% and 6.1%, respectively.

**Managed products** represents customer assets in our Core Portfolio, Blend Portfolio, Dedicated Portfolio and Fixed Income Portfolios. Managed products are a driver of fees and service charges revenue. Managed products were \$5.6 billion and \$4.3 billion at March 31, 2018 and 2017, respectively.

### Company Metrics:





**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 47% and 41% for the three months ended March 31, 2018 and 2017, respectively.

**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 and losses on early extinguishment of debt, which are not viewed as key factors governing our investment in the business and are excluded by management when evaluating operating margin performance. Adjusted operating margin was 44% and 38% for the three months ended March 31, 2018 and 2017, respectively. See *MD&A—Earnings Overview* for a reconciliation of adjusted operating margin to operating margin.

**Corporate cash**, a non-GAAP measure, is a component of **cash and equivalents** and represents the primary source of capital above and beyond the capital deployed in our regulated subsidiaries. Cash and equivalents was \$498 million and \$998 million at March 31, 2018 and 2017, respectively, while corporate cash was \$439 million and \$417 million for the same periods. See *MD&A—Liquidity and Capital Resources* for a reconciliation of corporate cash to cash and equivalents.

**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 7.3% and 7.2% at March 31, 2018 and 2017, respectively. E\*TRADE Bank's Tier 1 leverage ratio was 7.6% and 8.1% at March 31, 2018 and 2017, respectively. See *MD&A—Liquidity and Capital Resources* for additional information, including the calculation of regulatory capital ratios.

**Interest-earning assets**, along with net interest margin, is an indicator of our ability to generate net interest income. Average interest-earning assets were \$59.8 billion and \$48.7 billion for the three months ended March 31, 2018 and 2017, respectively.

**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 2.97% and 2.63% for the three months ended March 31, 2018 and 2017, respectively.

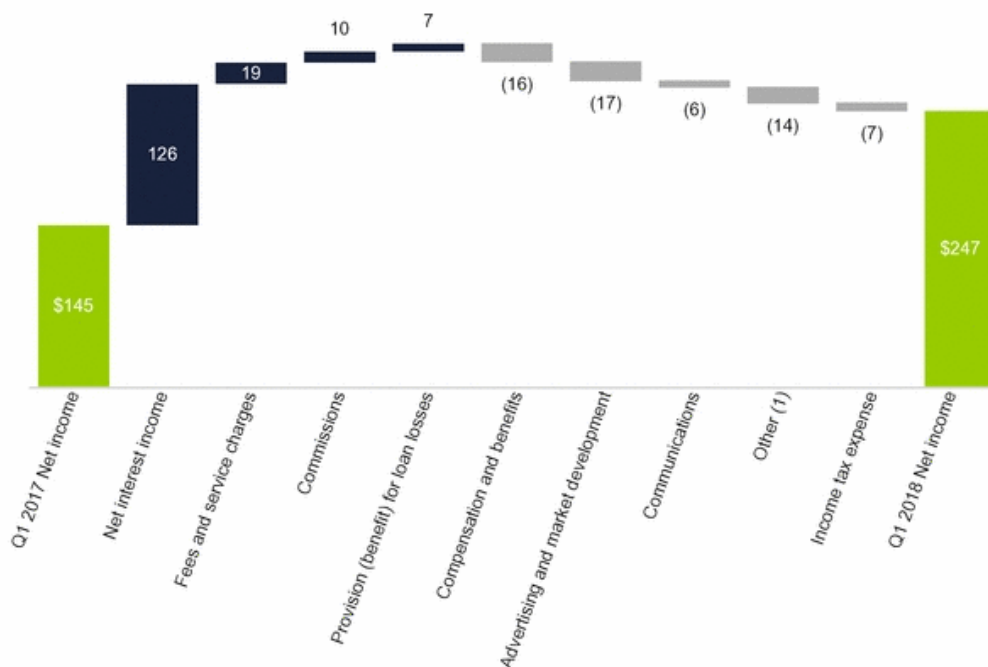
**Total employees** were 3,768 and 3,629 at March 31, 2018 and 2017, respectively.

## Regulatory Developments

In April 2016, the US Department of Labor (DOL) published its final Conflicts of Interest Rule- Retirement Investment Advice regulations under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986 (Fiduciary Rule). Certain aspects of the Fiduciary Rule became applicable in June 2017. The Fiduciary Rule generally subjects 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 DOL extended the transition period for the remaining aspects of the Fiduciary Rule, currently scheduled to take effect on July 1, 2019. On March 5, 2018, the Fifth Circuit Court of Appeals vacated the Fiduciary Rule in its entirety. If the decision is not reviewed or appealed, the Fiduciary Rule will be nullified as if it had not been adopted.

## EARNINGS OVERVIEW

We generated net income of \$247 million on total net revenue of \$708 million for the three months ended March 31, 2018. The following chart presents a reconciliation of net income for the three months ended March 31, 2017 to net income for the three months ended March 31, 2018 (dollars in millions):



- (1) Includes clearing and servicing, professional services, occupancy and equipment, depreciation and amortization, FDIC insurance premiums, amortization of other intangibles, restructuring and acquisition-related activities and other non-interest expenses.

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The following table presents significant components of the consolidated statement of income (dollars in millions except per share amounts):

	Three Months Ended March 31,		Variance	
	2018	2017	2018 vs. 2017	
			Amount	%
Net interest income	\$ 445	\$ 319	\$ 126	39 %
Total non-interest income	263	234	29	12 %
Total net revenue	708	553	155	28 %
Provision (benefit) for loan losses	(21)	(14)	(7)	50 %
Total non-interest expense	395	342	53	15 %
Income before income tax expense	334	225	109	48 %
Income tax expense	87	80	7	9 %
Net income	\$ 247	\$ 145	\$ 102	70 %
Preferred stock dividends	12	13	(1)	(8)%
Net income available to common shareholders	\$ 235	\$ 132	\$ 103	78 %
Diluted earnings per common share	\$ 0.88	\$ 0.48	\$ 0.40	83 %

Net income increased 70% to \$247 million for the three months ended March 31, 2018 compared to the same period in 2017. Net income available to common shareholders was \$235 million for the three months ended March 31, 2018, which reflects \$12 million in preferred stock dividends, compared to \$132 million, which reflects \$13 million in preferred stock dividends, during the same period in 2017. The increase in net income was primarily driven by higher interest income due to a larger average balance sheet and an improvement in net interest margin, as well as higher fees and service charges. A lower effective tax rate resulting from federal tax reform also added to the increase. The increase in net income was partially offset by higher non-interest expense primarily due to increased compensation and benefits and advertising and market development expenses.

## Net Revenue

The following table presents the significant components of net revenue (dollars in millions):

	Three Months Ended March 31,		Variance	
	2018	2017	2018 vs. 2017	
			Amount	%
Net interest income	\$ 445	\$ 319	\$ 126	39%
Commissions	137	127	10	8%
Fees and service charges	105	86	19	22%
Gains on securities and other, net	10	10	—	—%
Other revenue	11	11	—	—%
Total non-interest income	263	234	29	12%
Total net revenue	\$ 708	\$ 553	\$ 155	28%

## Net Interest Income

Net interest income increased 39% to \$445 million for the three months ended March 31, 2018, compared to the same period in 2017. Net interest income is earned primarily through investment securities, margin receivables and our legacy mortgage and consumer loan portfolio, offset by funding costs. Our investment grade debt refinancing in the third quarter of 2017 reduced our funding costs and improved our ability to generate net interest income.



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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 (dollars in millions):

	Three Months Ended March 31,					
	2018			2017		
	Average Balance	Interest Inc./Exp.	Average Yield/ Cost	Average Balance	Interest Inc./Exp.	Average Yield/ Cost
Cash and equivalents	\$ 803	\$ 3	1.42%	\$ 1,345	\$ 2	0.64%
Cash required to be segregated under federal or other regulations	795	3	1.62%	1,684	3	0.71%
Investment securities <sup>(1)</sup>	45,194	290	2.57%	34,117	205	2.41%
Margin receivables	9,466	103	4.41%	6,781	66	3.93%
Loans <sup>(2)</sup>	2,629	33	5.07%	3,608	43	4.77%
Broker-related receivables and other	950	4	1.55%	1,119	—	0.12%
Subtotal interest-earning assets	59,837	436	2.92%	48,654	319	2.63%
Other interest revenue <sup>(3)</sup>	—	32		—	22	
Total interest-earning assets	59,837	468	3.14%	48,654	341	2.81%
Total non-interest-earning assets	4,787			5,252		
Total assets	\$ 64,624			\$ 53,906		
Deposits	\$ 43,178	\$ 2	0.02%	\$ 34,869	\$ 1	0.01%
Customer payables	9,556	1	0.06%	8,686	1	0.06%
Broker-related payables and other	1,566	1	0.20%	1,160	—	0.00%
Other borrowings	932	7	3.12%	492	5	3.85%
Corporate debt	991	9	3.62%	994	14	5.39%
Subtotal interest-bearing liabilities	56,223	20	0.14%	46,201	21	0.18%
Other interest expense <sup>(4)</sup>	—	3		—	1	
Total interest-bearing liabilities	56,223	23	0.17%	46,201	22	0.19%
Total non-interest-bearing liabilities	1,329			1,402		
Total liabilities	57,552			47,603		
Total shareholders' equity	7,072			6,303		
Total liabilities and shareholders' equity	\$ 64,624			\$ 53,906		
Excess interest earning assets over interest bearing liabilities/net interest income/net interest margin	\$ 3,614	\$ 445	2.97%	\$ 2,453	\$ 319	2.63%

(1) For the three months ended March 31, 2018, includes a \$3 million net loss related to fair value hedging adjustments, previously referred to as hedge ineffectiveness.

Hedge ineffectiveness for the prior periods continues to be reflected within the gains on securities and other, net line item. See Note 7- *Derivative Instruments and Hedging Activities* for additional information.

(2) Nonaccrual loans are included in the average loan balances. Interest payments received on nonaccrual loans are 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.

(3) Represents interest income on securities loaned.

(4) Represents interest expense on securities borrowed.

Average interest-earning assets increased 23% to \$59.8 billion for the three months ended March 31, 2018 compared to the same period in 2017. 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 22% to \$56.2 billion for the three months ended March 31, 2018 compared to the same period in 2017. The increase was primarily due to higher deposits as a result of transferring customer cash held by third parties to our balance sheet.

Net interest margin increased 34 basis points to 2.97% for the three months ended March 31, 2018 compared to the same period in 2017. 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 March 31, 2018 compared to 2017 is due to higher interest rates earned on increased margin receivables and investment securities balances, increased securities lending activities and lower corporate

debt service cost, partially offset by the continued run-off of our higher yielding legacy mortgage and consumer loan portfolio.

## Commissions

Commissions revenue increased 8% to \$137 million for the three months ended March 31, 2018 compared to the same period in 2017. The main factors that affect commissions revenue are DARTs, average commission per trade and the number of trading days.

DARTs volume increased 49% to 309,469 for the three months ended March 31, 2018, compared to the same period in 2017, mainly driven by continued improved market sentiment along with the higher volatility of the equity markets. Derivative DARTs volume increased 65% to 97,658 for the three months ended March 31, 2018 compared to the same period in 2017. Derivative DARTs represented 32% and 29% of trading volume for the three months ended March 31, 2018 and 2017, respectively.

Average commission per trade decreased 26% to \$7.27 for the three months ended March 31, 2018 compared to the same period in 2017. 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 months ended March 31, 2018 was impacted by reduced commission rates implemented in March 2017 as well as increased trading activity from certain customers, qualifying them for lower active trader commission pricing.

## Fees and Service Charges

The following table presents the significant components of fees and service charges (dollars in millions):

	Three Months Ended March 31,		Variance	
	2018	2017	2018 vs. 2017	
			Amount	%
Order flow revenue	\$ 47	\$ 31	\$ 16	52 %
Money market funds and sweep deposits revenue <sup>(1)</sup>	17	22	(5)	(23)%
Mutual fund service fees	11	9	2	22 %
Advisor management fees	11	8	3	38 %
Foreign exchange revenue	8	8	—	— %
Reorganization fees	3	3	—	— %
Other fees and service charges	8	5	3	60 %
Total fees and service charges	\$ 105	\$ 86	\$ 19	22 %

(1) 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 22% to \$105 million for the three months ended March 31, 2018 compared to the same period in 2017 primarily driven by increased order flow revenue due to higher trade volume and improved rates. This increase was partially offset by decreased money market funds and sweep deposits revenue driven by lower customer cash balances held by third parties due to transferring cash onto our balance sheet. The impact of the lower balances was partially offset by a higher gross yield of 135 basis points for the three months ended March 31, 2018 as compared to approximately 60 basis points in 2017.

## Gains on Securities and Other, Net

The following table presents the significant components of gains on securities and other, net (dollars in millions):

	Three Months Ended March 31,		Variance 2018 vs. 2017	
	2018	2017	Amount	%
Gains on available-for-sale securities	\$ 11	\$ 8	\$ 3	38 %
Equity method investment income (loss) and other <sup>(1)</sup>	(1)	2	(3)	(150)%
Gains on securities and other, net	\$ 10	\$ 10	\$ —	— %

(1) Includes a loss of \$1 million on hedge ineffectiveness for the three months ended March 31, 2017. Beginning January 1, 2018, fair value hedging adjustments are recognized within net interest income. See *Note 1—Organization, basis of presentation and summary of significant accounting policies* for additional information.

## Provision (Benefit) for Loan Losses

We recognized a benefit for loan losses of \$21 million and \$14 million for the three months ended March 31, 2018 and 2017, respectively. The timing and magnitude of the provision (benefit) for loan losses is affected by many factors that could result in variability. These benefits reflected better than expected performance of our portfolio as well as recoveries in excess of prior expectations, including recoveries of previous charge-offs that were not included in our loss estimates. For additional information on management's estimate of the allowance for loan losses, see *Note 6—Loans Receivable, Net*.

## Non-Interest Expense

The following table presents the significant components of non-interest expense (dollars in millions):

	Three Months Ended March 31,		Variance 2018 vs. 2017	
	2018	2017	Amount	%
Compensation and benefits	\$ 152	\$ 136	\$ 16	12 %
Advertising and market development	60	43	17	40 %
Clearing and servicing	36	32	4	13 %
Professional services	22	22	—	— %
Occupancy and equipment	30	27	3	11 %
Communications	31	25	6	24 %
Depreciation and amortization	22	20	2	10 %
FDIC insurance premiums	9	8	1	13 %
Amortization of other intangibles	10	9	1	11 %
Restructuring and acquisition-related activities	—	4	(4)	(100)%
Other non-interest expenses	23	16	7	44 %
Total non-interest expense	\$ 395	\$ 342	\$ 53	15 %

## Compensation and Benefits

Compensation and benefits expense increased 12% to \$152 million for the three months ended March 31, 2018 compared to the same period in 2017. The expense increase was primarily driven by a 4% increase in headcount to support the growth in our business along with higher payroll taxes and incentive compensation related to strong company performance.

## Advertising and Market Development

Advertising and market development expense increased 40% to \$60 million for the three months ended March 31, 2018 compared to the same period in 2017. This planned increase was primarily due to higher media and brand production spend resulting from our increased focus on accelerating the growth of our business by increasing engagement across new and existing customers.

## Communications

Communications expense increased 24% to \$31 million for the three months ended March 31, 2018 compared to the same period in 2017. The increase was driven primarily by increased market data fees resulting from higher trading activity and the impact of higher rates for professional users.

## Other Non-Interest Expenses

Other non-interest expenses increased 44% to \$23 million for the three months ended March 31, 2018 compared to the same period in 2017. The increase was primarily driven by \$5 million in losses related to margin lending activity and futures transactions due to high market volatility experienced in early February 2018.

## Operating Margin

Operating margin was 47% for the three months ended March 31, 2018, compared to 41% for the same period in 2017. Adjusted operating margin, a non-GAAP measure, was 44% for the three months ended March 31, 2018 compared to 38% for the same period in 2017.

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 provision (benefit) for loan losses. The following table presents 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 March 31,			
	2018		2017	
	Amount	Operating Margin %	Amount	Operating Margin %
Income before income tax expense / operating margin	\$ 334	47%	\$ 225	41%
Provision (benefit) for loan losses	(21)		(14)	
Adjusted income before income tax expense / adjusted operating margin	<u>\$ 313</u>	44%	<u>\$ 211</u>	38%

## Income Tax Expense

Income tax expense was \$87 million and \$80 million for the three months ended March 31, 2018 and 2017, respectively. The effective tax rate was 26% and 36% for the same periods. The lower effective rate of 26% for the three months ended March 31, 2018 includes the impact of federal tax reform, which resulted in a lower federal tax rate beginning January 1, 2018.

## BALANCE SHEET OVERVIEW

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

	March 31, 2018	December 31, 2017	Variance 2018 vs. 2017	
			Amount	%
<b>Assets:</b>				
Cash and equivalents	\$ 498	\$ 931	\$ (433)	(47)%
Segregated cash	472	872	(400)	(46)%
Investment securities <sup>(1)</sup>	45,492	44,518	974	2 %
Margin receivables	10,515	9,071	1,444	16 %
Loans receivable, net	2,506	2,654	(148)	(6)%
Receivables from brokers, dealers and clearing organizations	735	1,178	(443)	(38)%
Goodwill and other intangibles, net	2,645	2,654	(9)	— %
Other <sup>(2)</sup>	1,324	1,487	(163)	(11)%
<b>Total assets</b>	<b>\$ 64,187</b>	<b>\$ 63,365</b>	<b>\$ 822</b>	<b>1 %</b>
<b>Liabilities and shareholders' equity:</b>				
Deposits	\$ 42,902	\$ 42,742	\$ 160	— %
Customer payables	8,947	9,449	(502)	(5)%
Payables to brokers, dealers and clearing organizations	2,892	1,542	1,350	88 %
Other borrowings	910	910	—	— %
Corporate debt	992	991	1	— %
Other liabilities	655	800	(145)	(18)%
<b>Total liabilities</b>	<b>57,298</b>	<b>56,434</b>	<b>864</b>	<b>2 %</b>
<b>Shareholders' equity</b>	<b>6,889</b>	<b>6,931</b>	<b>(42)</b>	<b>(1)%</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 64,187</b>	<b>\$ 63,365</b>	<b>\$ 822</b>	<b>1 %</b>

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

(2) Includes balance sheet line items property and equipment, net and other assets. Other assets includes deferred tax assets, net due to a presentation change beginning January 1, 2018. See *Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies* for additional information.

## Cash and Equivalents

Cash and equivalents decreased 47% to \$498 million during the three months ended March 31, 2018 and includes corporate cash, a non-GAAP measure, of \$439 million as of March 31, 2018. 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 *MD&A—Liquidity and Capital Resources* and the consolidated statement of cash flows.

## Segregated Cash

Cash required to be segregated under federal or other regulations decreased 46% to \$472 million during the three months ended March 31, 2018. 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 March 31, 2018 and December 31, 2017, \$750 million and \$800 million, respectively, of reverse repurchase agreements between E\*TRADE Securities and E\*TRADE Bank, representing investments that were segregated under federal or other regulations by E\*TRADE Securities, were eliminated in consolidation.

## Investment Securities

The following table presents the significant components of available-for-sale and held-to-maturity securities (dollars in millions):

	March 31, 2018	December 31, 2017	Variance 2018 vs. 2017	
			Amount	%
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$ 23,418	\$ 19,195	\$ 4,223	22 %
Other debt securities	1,417	1,477	(60)	(4)%
Total debt securities	24,835	20,672	4,163	20 %
Publicly traded equity securities <sup>(1)</sup>	—	7	(7)	(100)%
Total available-for-sale securities	\$ 24,835	\$ 20,679	\$ 4,156	20 %
Held-to-maturity securities:				
Agency mortgage-backed securities	\$ 17,482	\$ 20,502	\$ (3,020)	(15)%
Other debt securities	3,175	3,337	(162)	(5)%
Total held-to-maturity securities	\$ 20,657	\$ 23,839	\$ (3,182)	(13)%
Total investment securities	\$ 45,492	\$ 44,518	\$ 974	2 %

(1) Consists of investments in a mutual fund related to the Community Reinvestment Act. At March 31, 2018, these equity securities are included in other assets on the consolidated balance sheet as a result of the adoption of amended accounting guidance related to the classification and measurement of financial instruments. See *Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies* for additional information.

Securities represented 71% and 70% of total assets at March 31, 2018 and December 31, 2017, 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 following portfolio transfers occurred during the three months ended March 31, 2018:

- Securities with a carrying value of \$4.7 billion and related unrealized pre-tax gain of \$7 million were transferred from held-to-maturity securities to available-for-sale securities during the three months ended March 31, 2018, as part of a one-time transition election for early adopting the new derivatives and hedge accounting guidance.
- Securities with a fair value of \$1.2 billion were transferred from available-for-sale to held-to-maturity during the three months ended March 31, 2018 pursuant to an evaluation of our investment strategy and an assessment by management about our intent and ability to hold those particular securities until maturity.

See Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies, Note 5—Available-for-Sale and Held-to-Maturity Securities and Note 11—Shareholders' Equity for additional information.

## Margin Receivables

Margin receivables increased 16% to \$10.5 billion during the three months ended March 31, 2018. We believe recent market appreciation of customer assets provided additional capacity which, coupled with market sentiment, drove the increase in margin receivables.

## Loans Receivable, Net

The following table presents the significant components of loans receivable, net (dollars in millions):

	March 31, 2018	December 31, 2017	Variance 2018 vs. 2017	
			Amount	%
One- to four-family	\$ 1,339	\$ 1,432	\$ (93)	(6)%
Home equity	1,026	1,097	(71)	(6)%
Consumer and other <sup>(1)</sup>	189	188	1	1 %
Total loans receivable	2,554	2,717	(163)	(6)%
Unamortized premiums, net	10	11	(1)	(9)%
Subtotal	2,564	2,728	(164)	(6)%
Less: Allowance for loan losses	58	74	(16)	(22)%
Total loans receivable, net	\$ 2,506	\$ 2,654	\$ (148)	(6)%

(1) In 2017 we introduced E\*TRADE Line of Credit, a securities-based lending product, where customers can borrow up to 50% of the market value of securities pledged as collateral. The drawn amount and unused credit line amount totaled \$29 million and \$81 million, respectively, as of March 31, 2018 and \$12 million and \$35 million, respectively, as of December 31, 2017.

Loans receivable, net decreased 6% to \$2.5 billion during the three months ended March 31, 2018. We expect the remaining legacy mortgage and consumer 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 Note 6—Loans Receivable, Net.

## Deposits

The following table presents the significant components of deposits (dollars in millions):

	March 31, 2018	December 31, 2017	Variance 2018 vs. 2017	
			Amount	%
Sweep deposits	\$ 37,927	\$ 37,734	\$ 193	1 %
Savings deposits	2,797	2,912	(115)	(4)%
Other deposits	2,178	2,096	82	4 %
Total deposits	\$ 42,902	\$ 42,742	\$ 160	— %

Deposits represented 75% and 76% of total liabilities at March 31, 2018 and December 31, 2017, respectively. At March 31, 2018, 90% of our customer deposits were covered by FDIC insurance.

## Brokerage Related Cash

The majority of the deposits balance, specifically sweep deposits, is included in brokerage related cash, which is reported as a customer activity metric. The following table presents the significant components of total brokerage related cash (dollars in millions):

	March 31, 2018	December 31, 2017	Variance	
			2018 vs. 2017	
			Amount	%
Brokerage customer cash held on balance sheet:				
Sweep deposits	\$ 37,927	\$ 37,734	\$ 193	1 %
Customer payables	8,947	9,449	(502)	(5)%
Subtotal	46,874	47,183	(309)	(1)%
Customer cash held by third parties:				
Sweep deposits	3,444	4,724	(1,280)	(27)%
Money market funds and other	1,561	1,016	545	54 %
Subtotal	5,005	5,740	(735)	(13)%
Total brokerage related cash	\$ 51,879	\$ 52,923	\$ (1,044)	(2)%

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 March 31, 2018, 99% of sweep deposits were in the ESDA program. Sweep deposits on balance sheet are held at bank subsidiaries and are included in the deposits line item on our consolidated balance sheet.

Customer cash held by third parties is maintained at unaffiliated financial institutions. Customer cash held by third parties is not reflected on our consolidated balance sheet and is not immediately available for liquidity purposes.



## Receivables from and Payables to Brokers, Dealers and Clearing Organizations

The following table presents the significant components of receivables from and payables to brokers, dealers and clearing organizations (dollars in millions):

	March 31, 2018	December 31, 2017	Variance 2018 vs. 2017	
			Amount	%
Receivables:				
Securities borrowed	\$ 193	\$ 740	\$ (547)	(74)%
Receivables from clearing organizations	491	376	115	31 %
Other	51	62	(11)	(18)%
Total	<u>\$ 735</u>	<u>\$ 1,178</u>	<u>\$ (443)</u>	<u>(38)%</u>
Payables:				
Securities loaned	\$ 2,840	\$ 1,373	\$ 1,467	107 %
Payables to clearing organizations	9	123	(114)	(93)%
Other	43	46	(3)	(7)%
Total	<u>\$ 2,892</u>	<u>\$ 1,542</u>	<u>\$ 1,350</u>	<u>88 %</u>

Securities borrowed decreased 74% to \$193 million during the three months ended March 31, 2018. The decrease was driven by a lower demand for securities to cover customer short positions during the period.

Securities loaned increased 107% to \$2.8 billion during the three months ended March 31, 2018. The increase was driven by funding requirements at E\*TRADE Securities, primarily to support increased margin lending activity. For additional information on E\*TRADE Securities liquidity, see *MD&A—Liquidity and Capital Resources*.

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## LIQUIDITY AND CAPITAL RESOURCES

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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 E\*TRADE Securities. 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 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 the parent company's other non-bank subsidiaries are subject to various quantitative, arm's length, collateralization, capital and other requirements.

As a result of the Company's balance sheet growth, we became subject to the modified liquidity coverage ratio (LCR) requirement beginning April 1, 2018. The modified LCR rule requires us to hold at least 70% of our projected net cash outflows over a 30-day period in high-quality liquid assets. 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.

### *Parent Company Liquidity*

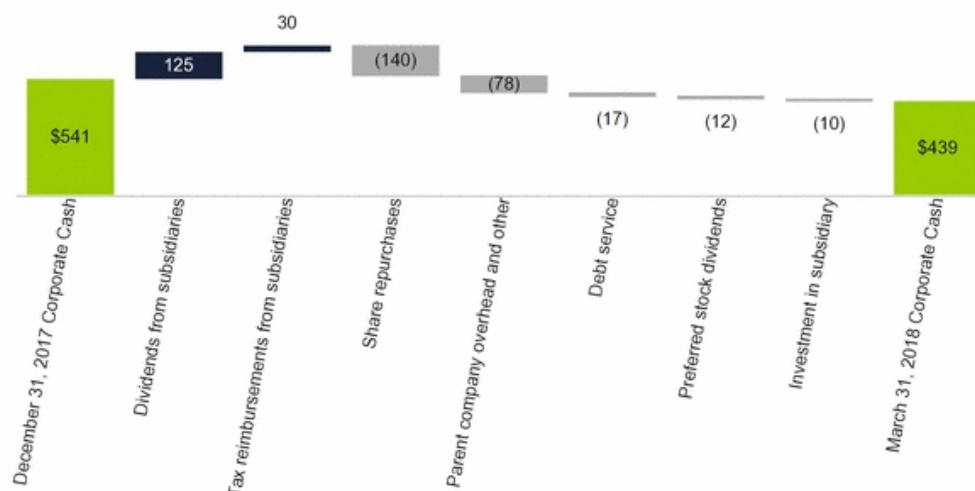
The parent company's primary source of liquidity is corporate cash. Corporate cash, a non-GAAP measure, is a component of cash and equivalents; see the consolidated statement of cash flows for information on cash and equivalents activity. We define corporate cash as cash held at the parent company and subsidiaries, excluding bank, broker-dealer, and FCM subsidiaries that require regulatory approval or notification prior to the payment of certain dividends to the parent company.

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 and investments in subsidiaries
- Non-cumulative preferred stock dividends
- Share repurchases
- Debt service costs
- Acquisitions and other investments
- Reimbursements from subsidiaries for the use of the parent company's deferred tax assets
- Parent company overhead less reimbursements through cost sharing arrangements with subsidiaries

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The following chart provides a roll forward of corporate cash at December 31, 2017 to corporate cash at March 31, 2018 (dollars in millions):



The following table presents a reconciliation of consolidated cash and equivalents to corporate cash, a non-GAAP measure (dollars in millions):

	March 31, 2018	December 31, 2017	March 31, 2017
Consolidated cash and equivalents	\$ 498	\$ 931	\$ 998
Less: Cash at regulated subsidiaries <sup>(1)</sup>	(59)	(390)	(581)
Corporate cash	<u>\$ 439</u>	<u>\$ 541</u>	<u>\$ 417</u>

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

Corporate cash decreased \$102 million to \$439 million during the three months ended March 31, 2018 primarily due to the following:

- \$140 million used for share repurchases
- \$78 million used primarily for parent company overhead less reimbursements from subsidiaries under cost sharing arrangements
- \$125 million received in dividends from E\*TRADE Securities

Corporate cash is monitored as part of our liquidity risk management and our current corporate cash target is \$250 million. This target covers approximately 18 months of parent company fixed costs, which includes preferred stock dividends, debt service and other overhead costs. The Company maintains \$300 million of additional liquidity through an unsecured committed revolving credit facility. The parent has the ability to borrow against the credit facility for working capital and general corporate purposes. At March 31, 2018, there was no outstanding balance under this credit facility. For additional information about our liquidity risk management

approach 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, 2017.

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

E\*TRADE Bank, including its subsidiary E\*TRADE Savings 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. Sweep deposits on our balance sheet as of March 31, 2018 increased \$0.2 billion compared to December 31, 2017. 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 March 31, 2018, E\*TRADE Bank had \$5.4 billion and \$0.7 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 March 31, 2018, 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 in 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 in June 2018 and a commitment fee of 0.15% on unused balances
- Unsecured uncommitted lines of credit with three unaffiliated banks, aggregating to \$125 million, of which \$50 million matures in June 2018 and the remaining lines have 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 March 31, 2018. E\*TRADE Securities also maintains lines of credit with the parent company and E\*TRADE Bank.

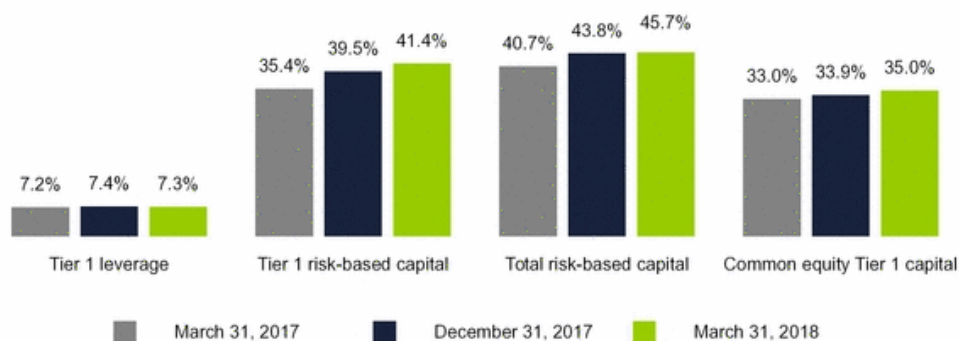
### **Capital Resources**

The Company seeks to manage capital levels in support of our business strategy of generating and effectively deploying capital for the benefit of our shareholders, governed by the Company's risk management framework. For additional information on our bank and brokerage capital requirements, see *Note 13—Regulatory Requirements*.

## 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. There are bank regulatory capital requirements applicable to the Company and E\*TRADE Bank, some of which are still subject to phase-in periods, including certain deductions from and adjustments to regulatory capital. Most of these requirements became fully implemented as of January 1, 2018. For additional information on bank regulatory requirements and phase-in periods, see *Overview—Regulatory Developments* as well as *Part I. Item 1. Business—Regulation* in our Annual Report on Form 10-K for the year ended December 31, 2017.

At March 31, 2018, 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 is 6.5%. E\*TRADE Financial's capital ratios are as follows:



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The following table presents the calculation of E\*TRADE Financial's capital ratios (dollars in millions):

	March 31, 2018	December 31, 2017	March 31, 2017
E*TRADE Financial shareholders' equity	\$ 6,889	\$ 6,931	\$ 6,444
Deduct:			
Preferred stock	(689)	(689)	(394)
E*TRADE Financial Common Equity Tier 1 capital before regulatory adjustments	\$ 6,200	\$ 6,242	\$ 6,050
Add:			
(Gains) losses in other comprehensive income on available-for-sale debt securities, net of tax	176	26	98
Deduct:			
Goodwill and other intangible assets, net of deferred tax liabilities	(2,219)	(2,191)	(2,058)
Disallowed deferred tax assets	(353)	(304)	(638)
E*TRADE Financial Common Equity Tier 1 capital	3,804	3,773	3,452
Add:			
Preferred stock	689	689	394
Deduct:			
Disallowed deferred tax assets	—	(76)	(136)
E*TRADE Financial Tier 1 capital	\$ 4,493	\$ 4,386	\$ 3,710
Add:			
Allowable allowance for loan losses	58	74	135
Non-qualifying capital instruments subject to phase-out (trust preferred securities)	414	414	414
E*TRADE Financial total capital	\$ 4,965	\$ 4,874	\$ 4,259
E*TRADE Financial average assets for leverage capital purposes	\$ 64,486	\$ 62,095	\$ 54,032
Deduct:			
Goodwill and other intangible assets, net of deferred tax liabilities	(2,219)	(2,191)	(2,058)
Disallowed deferred tax assets	(353)	(380)	(774)
E*TRADE Financial adjusted average assets for leverage capital purposes	\$ 61,914	\$ 59,524	\$ 51,200
E*TRADE Financial total risk-weighted assets <sup>(1)</sup>	\$ 10,856	\$ 11,115	\$ 10,466
E*TRADE Financial Tier 1 leverage ratio (Tier 1 capital / Adjusted average assets for leverage capital purposes)	7.3%	7.4%	7.2%
E*TRADE Financial Common Equity Tier 1 capital / Total risk-weighted assets <sup>(1)</sup>	35.0%	33.9%	33.0%
E*TRADE Financial Tier 1 capital / Total risk-weighted assets	41.4%	39.5%	35.4%
E*TRADE Financial total capital / Total risk-weighted assets	45.7%	43.8%	40.7%

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

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At March 31, 2018, 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 was reduced to 7.0% from 7.5% in January 2018. E\*TRADE Bank's capital ratios are as follows:



The following table presents the calculation of E\*TRADE Bank's capital ratios (dollars in millions):

	March 31, 2018	December 31, 2017	March 31, 2017
E*TRADE Bank shareholder's equity	\$ 3,721	\$ 3,703	\$ 3,291
Add:			
(Gains) losses in other comprehensive income on available-for-sale debt securities, net of tax	176	26	98
Deduct:			
Goodwill and other intangible assets, net of deferred tax liabilities	(38)	(38)	(38)
Disallowed deferred tax assets	(66)	(71)	(100)
E*TRADE Bank Common Equity Tier 1 capital / Tier 1 capital	3,793	3,620	3,251
Add:			
Allowable allowance for loan losses	58	74	118
E*TRADE Bank total capital	\$ 3,851	\$ 3,694	\$ 3,369
E*TRADE Bank average assets for leverage capital purposes	\$ 50,063	\$ 47,992	\$ 40,501
Deduct:			
Goodwill and other intangible assets, net of deferred tax liabilities	(38)	(38)	(38)
Disallowed deferred tax assets	(66)	(71)	(100)
E*TRADE Bank adjusted average assets for leverage capital purposes	\$ 49,959	\$ 47,883	\$ 40,363
E*TRADE Bank total risk-weighted assets <sup>(1)</sup>	\$ 10,133	\$ 10,147	\$ 9,280
E*TRADE Bank Tier 1 leverage ratio (Tier 1 capital / Adjusted average assets for leverage capital purposes)	7.6%	7.6%	8.1%
E*TRADE Bank Common Equity Tier 1 capital / Total risk-weighted assets	37.4%	35.7%	35.0%
E*TRADE Bank Tier 1 capital / Total risk-weighted assets	37.4%	35.7%	35.0%
E*TRADE Bank total capital / Total risk-weighted assets	38.0%	36.4%	36.3%

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

### **Broker-Dealer and FCM Capital Requirements**

Our broker-dealer and FCM subsidiaries are subject to capital requirements determined by their respective regulators. At March 31, 2018, these 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-dealer and FCM subsidiaries. E\*TRADE Securities paid dividends of \$125 million to the parent company during the three months ended March 31, 2018. For additional information on our broker-dealer and FCM capital requirements, see *Note 13—Regulatory Requirements*.

### **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*.

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## **RISK MANAGEMENT**

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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, liquidity, market, operational, information security, data, strategic, reputational, legal, as well as 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, 2017.

We are also subject to other risks that could affect our business, financial condition, results of operations or cash flows in future periods. For additional information see *Part I. Item 1A.—Risk Factors* in our Annual Report on Form 10-K for the year ended December 31, 2017.

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## **CONCENTRATIONS OF CREDIT RISK**

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Credit risk is the risk of loss arising from the inability or failure of a borrower or counterparty to meet its credit obligations. Our mortgage 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, 2017 for additional information on our management of credit risk.

### **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 March 31, 2018, nearly 100% of these loans were amortizing.



## **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 March 31, 2018, nearly 100% of the HELOC portfolio had converted from the interest-only draw period.

## **Securities**

We focus primarily on security type and credit rating to monitor credit risk in our securities portfolios. We consider securities backed by the US government or its agencies to have low credit risk as the long-term debt rating of the US government is AA+ by S&P and Aaa by Moody's at March 31, 2018. The amortized cost of these securities accounted for over 99% of our total securities portfolio at March 31, 2018. We review the remaining debt securities that were not backed by the US government or its agencies according to their credit ratings from S&P and Moody's where available. At March 31, 2018, 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 rating of "BBB-" or higher).

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## **SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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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, 2017, 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. Our 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, 2017.

## 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, 2017.

### 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 March 31, 2018, 94% of our total assets were interest-earning assets and we had no securities classified as trading.

At March 31, 2018, 68% 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.

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 securities lending and 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 following table presents the sensitivity of EVE and EAR at the consolidated E\*TRADE Financial level (dollars in millions):

Instantaneous Parallel Change in Interest Rates (basis points) <sup>(1)</sup>	Economic Value of Equity				Earnings-at-Risk			
	March 31, 2018		December 31, 2017		March 31, 2018		December 31, 2017	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
+200	\$ (155)	(1.8)%	\$ (172)	(2.1)%	\$ 217	11.9 %	\$ 197	11.5 %
+100	\$ 4	— %	\$ (23)	(0.3)%	\$ 116	6.4 %	\$ 113	6.6 %
-50	\$ (154)	(1.8)%	\$ (225)	(2.7)%	\$ (100)	(5.5)%	\$ (102)	(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.

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 March 31, 2018, the EVE and EAR percentage changes were within our Board limits.

## KEY TERMS

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

**Active trader**—Customers that execute 30 or more trades per quarter.

**Agency**—US 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 trades.

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

**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.

**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.

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

**DOL**—US Department of Labor.

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**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 Board of Governors of the Federal Reserve System and the twelve regional Federal Reserve Banks.

**Fiduciary Rule**—DOL's final Conflicts of Interest Rule- Retirement Investment Advice regulations under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986.

**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.

**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.

**LCR**—Liquidity coverage ratio. The purpose of the 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.

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

**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.

**RIA**—Registered Investment Adviser.

**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**—US Securities and Exchange Commission.

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

**TCA**—Trust Company of America, Inc.

**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.

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

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**E\*TRADE FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF INCOME**  
(In millions, except share data and per share amounts)  
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
Revenue:		
Interest income	\$ 468	\$ 341
Interest expense	(23)	(22)
Net interest income	445	319
Commissions	137	127
Fees and service charges	105	86
Gains on securities and other, net	10	10
Other revenue	11	11
Total non-interest income	263	234
Total net revenue	708	553
Provision (benefit) for loan losses	(21)	(14)
Non-interest expense:		
Compensation and benefits	152	136
Advertising and market development	60	43
Clearing and servicing	36	32
Professional services	22	22
Occupancy and equipment	30	27
Communications	31	25
Depreciation and amortization	22	20
FDIC insurance premiums	9	8
Amortization of other intangibles	10	9
Restructuring and acquisition-related activities	—	4
Other non-interest expenses	23	16
Total non-interest expense	395	342
Income before income tax expense	334	225
Income tax expense	87	80
Net income	\$ 247	\$ 145
Preferred stock dividends	12	13
Net income available to common shareholders	\$ 235	\$ 132
Basic earnings per common share	\$ 0.88	\$ 0.48
Diluted earnings per common share	\$ 0.88	\$ 0.48
Shares used in computation of per common share data:		
Basic (in thousands)	266,558	274,876
Diluted (in thousands)	267,699	276,277

See accompanying notes to the condensed consolidated financial statements

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

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Net income	\$ 247	\$ 145
Other comprehensive income, net of tax		
Available-for-sale securities:		
Unrealized gains (losses), net	(128)	46
Reclassification into earnings, net	(7)	(5)
Transfer of held-to-maturity securities to available-for-sale securities <sup>(1)</sup>	6	—
Net change from available-for-sale securities	(129)	41
Reclassification of foreign currency translation gains	—	(2)
Other comprehensive income (loss)	(129)	39
Comprehensive income	\$ 118	\$ 184

- (1) During the three months ended March 31, 2018, securities with a carrying value of \$4.7 billion and related unrealized pre-tax gain of \$7 million, or \$6 million net of tax, were transferred from held-to-maturity securities to available-for-sale securities as part of a one-time transition election for early adopting the new derivatives and hedge accounting guidance. See *Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies* for additional information.

See accompanying notes to the condensed consolidated financial statements

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

	March 31, 2018	December 31, 2017
<b><u>ASSETS</u></b>		
Cash and equivalents	\$ 498	\$ 931
Cash required to be segregated under federal or other regulations	472	872
Available-for-sale securities	24,835	20,679
Held-to-maturity securities (fair value of \$20,224 and \$23,719 at March 31, 2018 and December 31, 2017, respectively)	20,657	23,839
Margin receivables	10,515	9,071
Loans receivable, net (net of allowance for loan losses of \$58 and \$74 at March 31, 2018 and December 31, 2017, respectively)	2,506	2,654
Receivables from brokers, dealers and clearing organizations	735	1,178
Property and equipment, net	251	253
Goodwill	2,370	2,370
Other intangibles, net	275	284
Other assets	1,073	1,234
Total assets	<u>\$ 64,187</u>	<u>\$ 63,365</u>
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>		
<b>Liabilities:</b>		
Deposits	\$ 42,902	\$ 42,742
Customer payables	8,947	9,449
Payables to brokers, dealers and clearing organizations	2,892	1,542
Other borrowings	910	910
Corporate debt	992	991
Other liabilities	655	800
Total liabilities	<u>57,298</u>	<u>56,434</u>
Commitments and contingencies (see Note 14)		
<b>Shareholders' equity:</b>		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized, 403,000 shares issued and outstanding at both March 31, 2018 and December 31, 2017; aggregate liquidation preference of \$700 at both March 31, 2018 and December 31, 2017	689	689
Common stock, \$0.01 par value, 400,000,000 shares authorized, 264,792,847 and 266,827,881 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	3	3
Additional paid-in-capital	6,434	6,582
Accumulated deficit	(61)	(317)
Accumulated other comprehensive loss	(176)	(26)
Total shareholders' equity	<u>6,889</u>	<u>6,931</u>
Total liabilities and shareholders' equity	<u>\$ 64,187</u>	<u>\$ 63,365</u>

See accompanying notes to the condensed consolidated financial statements

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

	Preferred Stock	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Amount	Shares	Amount				
<b>Balance at December 31, 2017</b>	\$ 689	267	\$ 3	\$ 6,582	\$ (317)	\$ (26)	\$ 6,931
Cumulative effect of hedge accounting adoption	—	—	—	—	7	(7)	—
Reclassification of tax effects due to federal tax reform	—	—	—	—	14	(14)	—
Net income	—	—	—	—	247	—	247
Other comprehensive loss	—	—	—	—	—	(129)	(129)
Preferred stock dividends	—	—	—	—	(12)	—	(12)
Repurchases of common stock	—	(3)	—	(140)	—	—	(140)
Issuance of common stock for share-based compensation, net of shares withheld to pay taxes	—	1	—	(18)	—	—	(18)
Share-based compensation	—	—	—	10	—	—	10
<b>Balance at March 31, 2018</b>	<u>\$ 689</u>	<u>265</u>	<u>\$ 3</u>	<u>\$ 6,434</u>	<u>\$ (61)</u>	<u>\$ (176)</u>	<u>\$ 6,889</u>

	Preferred Stock	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Amount	Shares	Amount				
<b>Balance at December 31, 2016</b>	\$ 394	274	\$ 3	\$ 6,921	\$ (909)	\$ (137)	\$ 6,272
Cumulative effect of accounting change	—	—	—	—	3	—	3
Net income	—	—	—	—	145	—	145
Other comprehensive income	—	—	—	—	—	39	39
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	—	(15)	—	—	(15)
Share-based compensation	—	—	—	10	—	—	10
<b>Balance at March 31, 2017</b>	<u>\$ 394</u>	<u>275</u>	<u>\$ 3</u>	<u>\$ 6,919</u>	<u>\$ (774)</u>	<u>\$ (98)</u>	<u>\$ 6,444</u>

See accompanying notes to the condensed consolidated financial statements

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

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 247	\$ 145
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (benefit) for loan losses	(21)	(14)
Depreciation and amortization (including discount amortization and accretion)	65	61
Gains on securities and other, net	(10)	(10)
Share-based compensation	10	10
Deferred tax expense	78	81
Other	1	(4)
Net effect of changes in assets and liabilities:		
Decrease (increase) in receivables from brokers, dealers and clearing organizations	443	(354)
Increase in margin receivables	(1,444)	(175)
Decrease in other assets	367	13
Increase in payables to brokers, dealers and clearing organizations	1,350	305
(Decrease) increase in customer payables	(502)	767
Decrease in other liabilities	(38)	(44)
Net cash provided by operating activities	<u>546</u>	<u>781</u>
<b>Cash flows from investing activities:</b>		
Purchases of available-for-sale securities	(2,282)	(4,426)
Proceeds from sales of available-for-sale securities	797	248
Proceeds from maturities of and principal payments on available-for-sale securities	459	336
Purchases of held-to-maturity securities	(1,109)	(3,963)
Proceeds from maturities of and principal payments on held-to-maturity securities	593	513
Proceeds from sale of loans	15	—
Decrease in loans receivable	163	273
Capital expenditures for property and equipment	(21)	(23)
Proceeds from sale of real estate owned and repossessed assets	9	8
Net cash flow from derivative contracts	10	42
Other	(4)	2
Net cash used in investing activities	<u>(1,370)</u>	<u>(6,990)</u>

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

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from financing activities:</b>		
Increase in deposits	\$ 160	\$ 5,702
Preferred stock dividends	(12)	(13)
Advances from FHLB	1,550	—
Payments on advances from FHLB	(1,550)	—
Repurchases of common stock	(140)	—
Other	(17)	(16)
Net cash (used in) provided by financing activities	(9)	5,673
Decrease in cash, cash equivalents and segregated cash	(833)	(536)
Cash, cash equivalents and segregated cash, beginning of period	1,803	3,410
Cash, cash equivalents and segregated cash, end of period	<u>\$ 970</u>	<u>\$ 2,874</u>
Cash and equivalents, end of period	\$ 498	\$ 998
Segregated cash, end of period	472	1,876
Cash, cash equivalents and segregated cash, end of period	<u>\$ 970</u>	<u>\$ 2,874</u>
<b>Supplemental disclosures:</b>		
Cash paid for interest	\$ 30	\$ 20
Cash paid for income taxes, net of refunds	\$ 4	\$ 1
Non-cash investing and financing activities:		
Transfers from loans to other real estate owned and repossessed assets	\$ 6	\$ 6
Conversion of convertible debentures to common stock	\$ —	\$ 3
Transfer of available-for-sale securities to held-to-maturity securities	\$ 1,161	\$ —
Transfer of held-to-maturity securities to available-for-sale securities	\$ 4,672	\$ —

See accompanying notes to the condensed consolidated financial statements

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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

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**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, or, to the extent that a readily determinable fair value is available, at fair value through net income. 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 consolidated 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.

Beginning January 1, 2018, the Company updated the presentation of the consolidated financial statements as follows:

- On the consolidated balance sheet, deferred tax assets, net has been reclassified to other assets. The prior period has been reclassified to conform to the current period presentation. Deferred tax assets, net were \$218 million and \$251 million at March 31, 2018 and December 31, 2017, respectively.
- On the consolidated balance sheet, publicly traded equity securities are presented within other assets as a result of the adoption of amended accounting guidance. The prior period has not been reclassified as the amended accounting guidance was adopted on a modified retrospective basis. Accordingly, publicly traded equity securities for the prior period are presented within available-for-sale securities.
- On the consolidated statement of income, fair value hedging adjustments, previously referred to as hedge ineffectiveness, are included within net interest income as a result of the adoption of new accounting guidance. Prior period amounts have not been reclassified to current period presentation and continue to be reflected within gains on securities and other, net. Fair value hedging adjustments were expenses of \$3 million and \$1 million for the three months ended March 31, 2018 and March 31, 2017, respectively.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Use of Estimates**

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

**Adoption of New Accounting Standards**

***Revenue from Contracts with Customers***

In May 2014, the FASB amended the guidance on revenue from 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 was not impacted by the new standard. The FASB issued supplemental amendments to the new standard to clarify certain guidance and to provide narrow scope improvements and practical expedients during 2016. The amended guidance became effective on January 1, 2018 and the Company adopted the guidance on a modified retrospective basis. This adoption did not 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 materially consistent with the Company's previous revenue recognition policies. Similarly, the amended guidance did not have a material impact on the recognition of costs incurred to obtain new contracts. For additional information on the Company's adoption of the amended guidance, see *Note 2—Net Revenue*.

***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. The amended guidance became effective on January 1, 2018, and was applied on a modified retrospective basis. The adoption did not 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. Beginning January 1, 2018, publicly traded equity securities are presented within other assets on the consolidated balance sheet.

***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 became effective on January 1, 2018, and the retrospective transition method has been applied to each period presented. Among other changes, the Company will classify debt extinguishment costs within cash flows from financing activities.



**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

***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 new guidance became effective on January 1, 2018 and has been applied using a retrospective transition method to each period presented. The Company concluded that cash required to be segregated under federal or other regulations is considered restricted cash and the segregated cash activity is now presented on the consolidated statement of cash flows.

***Clarifying the Definition of a Business***

In January 2017, the FASB amended the 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 guidance, which became effective on January 1, 2018, did not change the Company's accounting conclusions for the TCA acquisition and is not expected to impact the Company's accounting conclusions for the acquisition of brokerage accounts from Capital One.

***Targeted Improvements to Accounting for Hedging Activities***

In August 2017, the FASB amended the guidance to update the recognition and presentation of hedging relationships. Among other changes, the new guidance eases hedge documentation requirements and allows additional types of hedge accounting strategies. The Company early adopted this guidance beginning January 1, 2018. The Company applied the guidance on a modified retrospective basis, which resulted in a \$7 million cumulative-effect adjustment to increase retained earnings and to decrease accumulated other comprehensive income. In addition, the guidance provided a one-time transition election to transfer certain debt securities from held-to-maturity to available-for-sale. The Company transferred agency mortgage-backed and agency debt securities with a fair value of \$4.7 billion, and recognized a net pre-tax gain of \$7 million within other comprehensive income. For additional information on the Company's adoption of the amended guidance, see *Note 7—Derivative Instruments and Hedging Activities*.

***Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income***

In February 2018, the FASB amended the guidance to address certain income tax effects in accumulated other comprehensive income resulting from the federal tax reform enacted in 2017. The amended guidance provides an option to reclassify tax effects within accumulated other comprehensive income to retained earnings in the period in which the effect of the tax reform is recorded. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods. Early adoption is permitted. The Company adopted the amended guidance in the first quarter of 2018 and recorded a \$14 million increase to retained earnings and a corresponding decrease to accumulated other comprehensive income.

***Premium Amortization on Purchased Callable Debt Securities***

In March 2017, the FASB amended the guidance on the amortization period for certain callable debt securities held at a premium. The amended guidance shortens the amortization period for these securities 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 Company early adopted this guidance beginning January 1, 2018; however, a cumulative-effect adjustment to retained earnings was not required upon adoption as the Company did not hold any callable debt securities at a premium as of January 1, 2018.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## **New Accounting Standards Not Yet Adopted**

### ***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 in the process of evaluating the new accounting guidance, which includes the assessment of whether certain executory contracts contain embedded leases. The Company has 30 regional financial centers and 8 corporate locations which are leased. The right of use asset and corresponding lease liability for these leases will be recognized on the Company's balance sheet upon adoption.

### ***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, including loans and debt securities, 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. 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 mortgage loans. The Company's evaluation contemplates the recent performance of the run-off legacy mortgage and consumer loan portfolio and the credit profile of the current investment securities portfolio; however, the impact of the new guidance will depend on the current and expected macroeconomic conditions and the nature and characteristics of financial assets held by the Company on the date of adoption.

### ***Simplifying the Test for Goodwill Impairment***

In January 2017, the FASB amended the 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.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## **NOTE 2—NET REVENUE**

The following table presents the significant components of total net revenue (dollars in millions):

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Net interest income	\$ 445	\$ 319
Commissions	137	127
Fees and service charges	105	86
Gains on securities and other, net	10	10
Other revenue	11	11
Total net revenue	<u>\$ 708</u>	<u>\$ 553</u>

## **Interest Income and Interest Expense**

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

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Interest income:		
Cash and equivalents	\$ 3	\$ 2
Cash required to be segregated under federal or other regulations	3	3
Investment securities <sup>(1)</sup>	290	205
Margin receivables	103	66
Loans	33	43
Broker-related receivables and other	4	—
Subtotal interest income	<u>436</u>	<u>319</u>
Other interest revenue <sup>(2)</sup>	<u>32</u>	<u>22</u>
Total interest income	<u>468</u>	<u>341</u>
Interest expense:		
Deposits	(2)	(1)
Customer payables	(1)	(1)
Broker-related payables and other	(1)	—
Other borrowings	(7)	(5)
Corporate debt	(9)	(14)
Subtotal interest expense	<u>(20)</u>	<u>(21)</u>
Other interest expense <sup>(3)</sup>	<u>(3)</u>	<u>(1)</u>
Total interest expense	<u>(23)</u>	<u>(22)</u>
Net interest income	<u>\$ 445</u>	<u>\$ 319</u>

(1) For the three months ended March 31, 2018, includes \$3 million of net fair value hedging adjustments. See *Note 7- Derivative Instruments and Hedging Activities* for additional information.

(2) Represents interest income on securities loaned.

(3) Represents interest expense on securities borrowed.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## **Fees and Service Charges**

The following table presents the significant components of fees and service charges revenue (dollars in millions):

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Fees and service charges:		
Order flow revenue	\$ 47	\$ 31
Money market funds and sweep deposits revenue	17	22
Mutual fund service fees	11	9
Advisor management fees	11	8
Foreign exchange revenue	8	8
Reorganization fees	3	3
Other fees and service charges	8	5
Total fees and service charges	<u>\$ 105</u>	<u>\$ 86</u>

## **Revenue from Contracts with Customers**

On January 1, 2018, the Company adopted the new accounting standard, *Revenue from Contracts with Customers*, and all the related amendments using the modified retrospective method.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in the new revenue recognition standard. The transaction price in a contract is allocated to each distinct performance obligation and is recognized as revenue when, or as, the performance obligation is satisfied.

### ***Commissions Revenue***

Commissions are derived from the Company's customers and are impacted by DARTs, average commission per trade and the number of trading days. Commission rates differ by trade type (e.g., equities, derivatives, stock plan and mutual funds) and are also impacted by lower pricing for customers that qualify for active trader pricing. For certain trade types, such as options contracts, the total commission earned varies based on contract volume. Commissions from securities transactions are recognized on a trade-date basis.

### ***Order Flow Revenue***

Order flow revenue is generated from market centers that accept trade orders from customer securities transactions. Order flow revenue is recognized on a trade-date basis when the Company has satisfied its performance obligation to the market center.

### ***Money Market Funds and Sweep Deposits Revenue***

Money market funds and sweep deposits revenue is driven by fees earned from off-balance sheet customer cash. This revenue is typically based on the average daily balance and the federal funds rate or LIBOR plus a negotiated spread.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Other**

Revenue is recognized on other components of fees and service charges when or as the performance obligations are satisfied. Mutual fund service fees are asset-based fees that are driven by the amount of customer assets invested in each fund. Advisor management fees are generally earned based on a percentage of customer assets under management.

Fees from software and services for managing equity compensation plans are recognized as the performance obligations are satisfied and are presented within other revenue on the consolidated statement of income.

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**NOTE 3—FAIR VALUE DISCLOSURES**

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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

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.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## **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 US 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 US Treasuries is based on the original maturity dates of the securities and whether the securities are the most recent issuances of a given maturity. US Treasuries with original maturities less than one year are classified as Level 1. US Treasuries with original maturities greater 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 March 31, 2018. 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 swaps 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 and overnight indexed swap basis from a financial data provider. The Company does not consider these models to involve significant judgment on the part of management, and the Company corroborated the fair value measurements with counterparty valuations. The Company's derivative instruments were categorized in Level 2 of the fair value hierarchy. The consideration of credit risk, the Company's or the counterparty's, did not result in an adjustment to the valuation of its derivative instruments in the periods presented.

## **Nonrecurring Fair Value Measurement Techniques**

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

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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, automated valuation models or updated values using home price indices. 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 loans, 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:

	Unobservable Inputs		Average	Range
<b><u>March 31, 2018</u></b>				
Loans receivable:				
One- to four-family	Appraised value	\$	714,300	\$250,000 - \$1,750,000
Home equity	Appraised value	\$	274,400	\$65,000 - \$550,000
Real estate owned	Appraised value	\$	280,300	\$31,500 - \$750,000
<b><u>December 31, 2017</u></b>				
Loans receivable:				
One- to four-family	Appraised value	\$	520,700	\$60,000 - \$1,200,000
Home equity	Appraised value	\$	317,300	\$38,000 - \$2,066,000
Real estate owned	Appraised value	\$	355,200	\$4,500 - \$2,000,000

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## Recurring and Nonrecurring Fair Value Measurements

The following table presents the significant components of assets and liabilities measured at fair value (dollars in millions):

	Level 1	Level 2	Level 3	Total Fair Value
<b>March 31, 2018:</b>				
<b>Recurring fair value measurements:</b>				
<b>Assets</b>				
Available-for-sale securities:				
Agency mortgage-backed securities	\$ —	\$ 23,418	\$ —	\$ 23,418
Agency debentures	—	869	—	869
US Treasuries	—	439	—	439
Agency debt securities	—	90	—	90
Municipal bonds	—	19	—	19
Total available-for-sale securities	—	24,835	—	24,835
Other assets:				
Derivative assets <sup>(1)</sup>	—	4	—	4
Publicly traded equity securities <sup>(2)</sup>	7	—	—	7
Total assets measured at fair value on a recurring basis <sup>(3)</sup>	\$ 7	\$ 24,839	\$ —	\$ 24,846
<b>Nonrecurring fair value measurements:</b>				
Loans receivable, net:				
One- to four-family	\$ —	\$ —	\$ 10	\$ 10
Home equity	—	—	2	2
Total loans receivable	—	—	12	12
Other assets:				
Real estate owned	—	—	13	13
Total assets measured at fair value on a nonrecurring basis <sup>(4)</sup>	\$ —	\$ —	\$ 25	\$ 25

- (1) All derivative assets and liabilities were interest rate contracts at March 31, 2018. Information related to derivative instruments is detailed in *Note 7—Derivative Instruments and Hedging Activities*.
- (2) Consists of investments in a mutual fund related to the Community Reinvestment Act. At March 31, 2018 these equity securities are included in other assets on the consolidated balance sheet as a result of the adoption of amended accounting guidance. See *Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies* for additional information.
- (3) Assets measured at fair value on a recurring basis represented 39% of the Company's total assets at March 31, 2018.
- (4) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet at March 31, 2018, and for which a fair value measurement was recorded during the period.



**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

	Level 1	Level 2	Level 3	Total Fair Value
<b>December 31, 2017:</b>				
<b>Recurring fair value measurements:</b>				
<b>Assets</b>				
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$ —	\$ 19,195	\$ —	\$ 19,195
Agency debentures	—	966	—	966
US Treasuries	—	458	—	458
Agency debt securities	—	33	—	33
Municipal bonds	—	20	—	20
Total debt securities	—	20,672	—	20,672
Publicly traded equity securities	7	—	—	7
Total available-for-sale securities	7	20,672	—	20,679
Receivables from brokers, dealers and clearing organizations:				
US Treasuries	300	—	—	300
Other assets:				
Derivative assets <sup>(1)</sup>	—	131	—	131
Total assets measured at fair value on a recurring basis <sup>(2)</sup>	\$ 307	\$ 20,803	\$ —	\$ 21,110
<b>Liabilities</b>				
Other liabilities:				
Derivative liabilities <sup>(1)</sup>	\$ —	\$ 14	\$ —	\$ 14
Total liabilities measured at fair value on a recurring basis <sup>(2)</sup>	\$ —	\$ 14	\$ —	\$ 14
<b>Nonrecurring fair value measurements:</b>				
Loans receivable, net:				
One- to four-family	\$ —	\$ —	\$ 22	\$ 22
Home equity	—	—	13	13
Total loans receivable	—	—	35	35
Other assets:				
Loans held-for-sale	—	17	—	17
Real estate owned	—	—	26	26
Total assets measured at fair value on a nonrecurring basis <sup>(3)</sup>	\$ —	\$ 17	\$ 61	\$ 78

(1) All derivative assets and liabilities were interest rate contracts at December 31, 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 December 31, 2017.

(3) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet at December 31, 2017, and for which a fair value measurement was recorded during the period.

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The following table presents losses recognized on assets measured at fair value on a nonrecurring basis (dollars in millions):

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
One- to four-family	\$ 1	\$ 1
Home equity	—	1
Total losses on loans receivable measured at fair value	<u>\$ 1</u>	<u>\$ 2</u>
Losses on real estate owned measured at fair value	<u>\$ —</u>	<u>\$ 1</u>

***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 three months ended March 31, 2018 and 2017.

***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.

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**Fair Value of Financial Instruments Not Carried at Fair Value**

The following table presents 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 (dollars in millions):

	March 31, 2018				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets</b>					
Cash and equivalents	\$ 498	\$ 498	\$ —	\$ —	\$ 498
Cash required to be segregated under federal or other regulations	\$ 472	\$ 472	\$ —	\$ —	\$ 472
Held-to-maturity securities:					
Agency mortgage-backed securities	\$ 17,482	\$ —	\$ 17,120	\$ —	\$ 17,120
Agency debentures	987	—	968	—	968
Agency debt securities	2,176	—	2,124	—	2,124
Other	12	—	—	12	12
Total held-to-maturity securities	<u>\$ 20,657</u>	<u>\$ —</u>	<u>\$ 20,212</u>	<u>\$ 12</u>	<u>\$ 20,224</u>
Margin receivables <sup>(1)</sup>	\$ 10,515	\$ —	\$ 10,515	\$ —	\$ 10,515
Loans receivable, net:					
One- to four-family	\$ 1,327	\$ —	\$ —	\$ 1,391	\$ 1,391
Home equity	991	—	—	1,002	1,002
Consumer and other	188	—	—	186	186
Total loans receivable, net <sup>(2)</sup>	<u>\$ 2,506</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,579</u>	<u>\$ 2,579</u>
Receivables from brokers, dealers and clearing organizations <sup>(1)</sup>	\$ 735	\$ —	\$ 735	\$ —	\$ 735
Other assets <sup>(1)(3)</sup>	\$ 21	\$ —	\$ 21	\$ —	\$ 21
<b>Liabilities</b>					
Deposits	\$ 42,902	\$ —	\$ 42,901	\$ —	\$ 42,901
Customer payables	\$ 8,947	\$ —	\$ 8,947	\$ —	\$ 8,947
Payables to brokers, dealers and clearing organizations	\$ 2,892	\$ —	\$ 2,892	\$ —	\$ 2,892
Other borrowings:					
FHLB advances	\$ 500	\$ —	\$ 500	\$ —	\$ 500
Trust preferred securities	\$ 410	\$ —	\$ —	\$ 392	\$ 392
Total other borrowings	<u>\$ 910</u>	<u>\$ —</u>	<u>\$ 500</u>	<u>\$ 392</u>	<u>\$ 892</u>
Corporate debt	\$ 992	\$ —	\$ 971	\$ —	\$ 971

- (1) The fair value of securities that the Company received as collateral in connection with margin receivables and securities borrowing activities, including the fully paid lending program, where the Company is permitted to sell or re-pledge the securities, was \$14.1 billion at March 31, 2018. Of this amount, \$5.5 billion had been pledged or sold in connection with securities loaned and deposits with clearing organizations at March 31, 2018.
- (2) The carrying value of loans receivable, net includes the allowance for loan losses of \$58 million and loans that are recorded at fair value on a nonrecurring basis at March 31, 2018.
- (3) The \$21 million in other assets at March 31, 2018 represents securities borrowing from customers under the fully paid lending program.

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	December 31, 2017				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets</b>					
Cash and equivalents	\$ 931	\$ 931	\$ —	\$ —	\$ 931
Cash required to be segregated under federal or other regulations	\$ 872	\$ 872	\$ —	\$ —	\$ 872
Held-to-maturity securities:					
Agency mortgage-backed securities	\$ 20,502	\$ —	\$ 20,404	\$ —	\$ 20,404
Agency debentures	710	—	708	—	708
Agency debt securities	2,615	—	2,595	—	2,595
Other	12	—	—	12	12
Total held-to-maturity securities	<u>\$ 23,839</u>	<u>\$ —</u>	<u>\$ 23,707</u>	<u>\$ 12</u>	<u>\$ 23,719</u>
Margin receivables <sup>(1)</sup>	\$ 9,071	\$ —	\$ 9,071	\$ —	\$ 9,071
Loans receivable, net:					
One- to four-family	\$ 1,417	\$ —	\$ —	\$ 1,463	\$ 1,463
Home equity	1,051	—	—	1,055	1,055
Consumer and other	186	—	—	187	187
Total loans receivable, net <sup>(2)</sup>	<u>\$ 2,654</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,705</u>	<u>\$ 2,705</u>
Receivables from brokers, dealers and clearing organizations <sup>(1)</sup>	\$ 878	\$ —	\$ 878	\$ —	\$ 878
Other assets <sup>(1)(3)</sup>	\$ 18	\$ —	\$ 18	\$ —	\$ 18
<b>Liabilities</b>					
Deposits	\$ 42,742	\$ —	\$ 42,741	\$ —	\$ 42,741
Customer Payables	\$ 9,449	\$ —	\$ 9,449	\$ —	\$ 9,449
Payables to brokers, dealers and clearing organizations	\$ 1,542	\$ —	\$ 1,542	\$ —	\$ 1,542
Other borrowings:					
FHLB advances	\$ 500	\$ —	\$ 500	\$ —	\$ 500
Trust preferred securities	\$ 410	\$ —	\$ —	\$ 379	\$ 379
Total other borrowings	<u>\$ 910</u>	<u>\$ —</u>	<u>\$ 500</u>	<u>\$ 379</u>	<u>\$ 879</u>
Corporate debt	\$ 991	\$ —	\$ 992	\$ —	\$ 992

(1) 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 \$12.8 billion at December 31, 2017. Of this amount, \$3.2 billion had been pledged or sold in connection with securities loaned and deposits with clearing organizations at December 31, 2017.

(2) The carrying value of loans receivable, net includes the allowance for loan losses of \$74 million and loans that are recorded at fair value on a nonrecurring basis at December 31, 2017.

(3) The \$18 million in other assets at December 31, 2017 represents securities borrowing from customers under the fully paid lending program.

The fair value measurement techniques for financial instruments not carried at fair value on the consolidated balance sheet 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, payables to*

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*brokers, dealers and clearing organizations and other assets*—Due to their short term nature, fair value is estimated to be carrying value.

*Held-to-maturity securities*—Fair value of held-to-maturity securities is determined in a manner consistent 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 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*—Fair value of certificates of deposit 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.

*FHLB advances*—Fair value for 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*—Fair value is estimated by discounting future cash flows at the yield implied by dealer pricing quotes.

*Corporate debt*—Fair value is estimated using dealer pricing quotes.

### **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. Information related to such commitments and contingent liabilities is included in *Note 14—Commitments, Contingencies and Other Regulatory Matters*.

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**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 the Company's derivative instruments, securities borrowing and securities lending transactions which are transacted under master agreements 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 (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
<b><u>March 31, 2018</u></b>						
Assets:						
Deposits paid for securities borrowed <sup>(2)</sup>	\$ 215	\$ —	\$ 215	\$ (174)	\$ (31)	\$ 10
Derivative assets <sup>(3)</sup>	4	—	4	—	(2)	2
Total	<u>\$ 219</u>	<u>\$ —</u>	<u>\$ 219</u>	<u>\$ (174)</u>	<u>\$ (33)</u>	<u>\$ 12</u>
Liabilities:						
Deposits received for securities loaned <sup>(4)</sup>	\$ 2,840	\$ —	\$ 2,840	\$ (174)	\$ (2,531)	\$ 135
Total	<u>\$ 2,840</u>	<u>\$ —</u>	<u>\$ 2,840</u>	<u>\$ (174)</u>	<u>\$ (2,531)</u>	<u>\$ 135</u>
<b><u>December 31, 2017</u></b>						
Assets:						
Deposits paid for securities borrowed <sup>(2)</sup>	\$ 759	\$ —	\$ 759	\$ (251)	\$ (483)	\$ 25
Total	<u>\$ 759</u>	<u>\$ —</u>	<u>\$ 759</u>	<u>\$ (251)</u>	<u>\$ (483)</u>	<u>\$ 25</u>
Liabilities:						
Deposits received for securities loaned <sup>(4)</sup>	\$ 1,373	\$ —	\$ 1,373	\$ (251)	\$ (1,004)	\$ 118
Derivative liabilities <sup>(5)(6)</sup>	5	—	5	—	(5)	—
Total	<u>\$ 1,378</u>	<u>\$ —</u>	<u>\$ 1,378</u>	<u>\$ (251)</u>	<u>\$ (1,009)</u>	<u>\$ 118</u>

- (1) The vast majority of the net amount of deposits paid for securities borrowed are reflected in the receivables from brokers, dealers and clearing organizations line item while the deposits paid for securities borrowed under the fully paid program are reflected in other assets. Derivative assets are reflected in the other assets line item in the consolidated balance sheet. Net amount of deposits received for securities loaned are reflected in the payables to brokers, dealers and clearing organizations line item in the consolidated balance sheet. Derivative liabilities are reflected in the other liabilities line item in the consolidated balance sheet.

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- (2) Included in the gross amounts of deposits paid for securities borrowed was \$67 million and \$347 million at March 31, 2018 and December 31, 2017, 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.
- (3) Collateral received included cash at March 31, 2018.
- (4) Included in the gross amounts of deposits received for securities loaned was \$2 billion and \$821 million at March 31, 2018 and December 31, 2017, respectively, transacted through a program with a clearing organization, which guarantees the return of securities to the Company. For presentation purposes, these amounts presented are based on the counterparties under the Company's master securities loan agreements.
- (5) Excludes net accrued interest payable of \$2 million at December 31, 2017.
- (6) Collateral pledged included held-to-maturity securities at amortized cost at December 31, 2017.

### **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.

### **Derivative Transactions**

Certain types of derivatives that the Company utilizes in its hedging activities are subject to derivatives clearing agreements (cleared derivatives contracts). 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. See *Note 7—Derivative Instruments and Hedging Activities* for additional information.

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

The following table presents the amortized cost and fair value of available-for-sale and held-to-maturity securities (dollars in millions):

	Amortized Cost	Gross Unrealized / Unrecognized Gains	Gross Unrealized / Unrecognized Losses	Fair Value
<b>March 31, 2018:</b>				
Available-for-sale securities: <sup>(1)</sup>				
Agency mortgage-backed securities	\$ 23,781	\$ 113	\$ (476)	\$ 23,418
Agency debentures	854	24	(9)	869
US Treasuries	407	32	—	439
Agency debt securities	91	—	(1)	90
Municipal bonds	19	—	—	19
Total available-for-sale securities	<u>\$ 25,152</u>	<u>\$ 169</u>	<u>\$ (486)</u>	<u>\$ 24,835</u>
Held-to-maturity securities: <sup>(1)</sup>				
Agency mortgage-backed securities	\$ 17,482	\$ 24	\$ (386)	\$ 17,120
Agency debentures	987	—	(19)	968
Agency debt securities	2,176	5	(57)	2,124
Other	12	—	—	12
Total held-to-maturity securities	<u>\$ 20,657</u>	<u>\$ 29</u>	<u>\$ (462)</u>	<u>\$ 20,224</u>
<b>December 31, 2017:</b>				
Available-for-sale securities:				
Debt securities:				
Agency mortgage-backed securities	\$ 19,395	\$ 47	\$ (247)	\$ 19,195
Agency debentures	939	39	(12)	966
US Treasuries	452	10	(4)	458
Agency debt securities	34	—	(1)	33
Municipal bonds	20	—	—	20
Total debt securities	20,840	96	(264)	20,672
Publicly traded equity securities <sup>(2)</sup>	7	—	—	7
Total available-for-sale securities	<u>\$ 20,847</u>	<u>\$ 96</u>	<u>\$ (264)</u>	<u>\$ 20,679</u>
Held-to-maturity securities:				
Agency mortgage-backed securities	\$ 20,502	\$ 95	\$ (193)	\$ 20,404
Agency debentures	710	—	(2)	708
Agency debt securities	2,615	15	(35)	2,595
Other	12	—	—	12
Total held-to-maturity securities	<u>\$ 23,839</u>	<u>\$ 110</u>	<u>\$ (230)</u>	<u>\$ 23,719</u>

- (1) Securities with a carrying value of \$4.7 billion and related unrealized pre-tax gain of \$7 million were transferred from held-to-maturity securities to available-for-sale securities during the three months ended March 31, 2018, as part of a one-time transition election for early adopting the new derivatives and hedge accounting guidance. Securities with a fair value of \$1.2 billion were transferred from available-for-sale securities to held-to-maturity securities during the three months ended March 31, 2018 pursuant to an evaluation of our investment strategy and an assessment by management about our intent and ability to



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hold those particular securities until maturity. See *Note 11—Shareholders' Equity* for information on the impact to accumulated other comprehensive income.

- (2) Consists of investments in a mutual fund related to the Community Reinvestment Act. At March 31, 2018 these equity securities are included in other assets on the consolidated balance sheet as a result of the adoption of amended accounting guidance related to the classification and measurement of financial instruments. See *Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies* for additional information.

## Contractual Maturities

The following table presents the contractual maturities of all available-for-sale and held-to-maturity debt securities (dollars in millions):

	March 31, 2018	
	Amortized Cost	Fair Value
Available-for-sale debt securities:		
Due within one year	\$ —	\$ —
Due within one to five years	998	978
Due within five to ten years	10,117	10,031
Due after ten years	14,037	13,826
Total available-for-sale debt securities	<u>\$ 25,152</u>	<u>\$ 24,835</u>
Held-to-maturity debt securities:		
Due within one year	\$ 135	\$ 135
Due within one to five years	1,509	1,491
Due within five to ten years	5,053	4,936
Due after ten years	13,960	13,662
Total held-to-maturity debt securities	<u>\$ 20,657</u>	<u>\$ 20,224</u>

At March 31, 2018 and December 31, 2017, the Company had pledged \$4.8 billion and \$5.5 billion, respectively, of held-to-maturity debt securities, and \$470 million and \$352 million, respectively, of available-for-sale securities, as collateral for FHLB advances, derivatives and other purposes.

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### Investments with Unrealized or Unrecognized Losses

The following table presents the fair value and unrealized or unrecognized losses on available-for-sale and held-to-maturity securities, and the length of time that individual securities have been in a continuous unrealized or unrecognized loss position (dollars in millions):

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized / Unrecognized Losses	Fair Value	Unrealized / Unrecognized Losses	Fair Value	Unrealized / Unrecognized Losses
<b>March 31, 2018:</b>						
Available-for-sale securities:						
Agency mortgage-backed securities	\$ 7,269	\$ (118)	\$ 8,661	\$ (358)	\$ 15,930	\$ (476)
Agency debentures	202	(2)	115	(7)	317	(9)
Agency debt securities	48	—	22	(1)	70	(1)
Municipal bonds	—	—	10	—	10	—
Total temporarily impaired available-for-sale securities	<u>\$ 7,519</u>	<u>\$ (120)</u>	<u>\$ 8,808</u>	<u>\$ (366)</u>	<u>\$ 16,327</u>	<u>\$ (486)</u>
Held-to-maturity securities:						
Agency mortgage-backed securities	\$ 10,988	\$ (234)	\$ 3,836	\$ (152)	\$ 14,824	\$ (386)
Agency debentures	817	(16)	151	(3)	968	(19)
Agency debt securities	582	(10)	1,206	(47)	1,788	(57)
Total temporarily impaired held-to-maturity securities	<u>\$ 12,387</u>	<u>\$ (260)</u>	<u>\$ 5,193</u>	<u>\$ (202)</u>	<u>\$ 17,580</u>	<u>\$ (462)</u>
<b>December 31, 2017:</b>						
Available-for-sale securities:						
Debt securities:						
Agency mortgage-backed securities	\$ 4,638	\$ (23)	\$ 8,027	\$ (224)	\$ 12,665	\$ (247)
Agency debentures	—	—	283	(12)	283	(12)
US Treasuries	—	—	147	(4)	147	(4)
Agency debt securities	9	—	24	(1)	33	(1)
Municipal bonds	—	—	11	—	11	—
Publicly traded equity securities	7	—	—	—	7	—
Total temporarily impaired available-for-sale securities	<u>\$ 4,654</u>	<u>\$ (23)</u>	<u>\$ 8,492</u>	<u>\$ (241)</u>	<u>\$ 13,146</u>	<u>\$ (264)</u>
Held-to-maturity securities:						
Agency mortgage-backed securities	\$ 9,982	\$ (78)	\$ 4,906	\$ (115)	\$ 14,888	\$ (193)
Agency debentures	597	(2)	9	—	606	(2)
Agency debt securities	373	(3)	1,345	(32)	1,718	(35)
Total temporarily impaired held-to-maturity securities	<u>\$ 10,952</u>	<u>\$ (83)</u>	<u>\$ 6,260</u>	<u>\$ (147)</u>	<u>\$ 17,212</u>	<u>\$ (230)</u>

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 March 31, 2018 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

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securities before the anticipated recovery of its remaining amortized cost of the debt securities in an unrealized or unrecognized loss position at March 31, 2018.

There were no impairment losses recognized in earnings on available-for-sale or held-to-maturity securities during the three months ended March 31, 2018 and 2017.

### **Gains on Securities and Other, Net**

The following table presents the components of gains on securities and other, net (dollars in millions):

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Gains on available-for-sale securities	\$ 11	\$ 8
Equity method investment income (loss) and other <sup>(1)</sup>	(1)	2
Gains on securities and other, net	<u>\$ 10</u>	<u>\$ 10</u>

(1) Includes a loss of \$1 million on hedge ineffectiveness for the three months ended March 31, 2017. Beginning January 1, 2018 fair value hedging adjustments are recognized within net interest income. See *Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies* for additional information.

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**NOTE 6—LOANS RECEIVABLE, NET**


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The following table presents loans receivable disaggregated by delinquency status (dollars in millions):

		Days Past Due							
	Current	30-89	90-179	180+	Total	Unamortized premiums, net	Allowance for loans losses	Loans Receivable, Net	
<b>March 31, 2018</b>									
One- to four-family	\$ 1,192	\$ 57	\$ 17	\$ 73	\$ 1,339	\$ 8	\$ (20)	\$ 1,327	
Home equity	947	34	15	30	1,026	—	(35)	991	
Consumer and other	186	2	1	—	189	2	(3)	188	
Total loans receivable	<u>\$ 2,325</u>	<u>\$ 93</u>	<u>\$ 33</u>	<u>\$ 103</u>	<u>\$ 2,554</u>	<u>\$ 10</u>	<u>\$ (58)</u>	<u>\$ 2,506</u>	
<b>December 31, 2017</b>									
One- to four-family	\$ 1,269	\$ 59	\$ 22	\$ 82	\$ 1,432	\$ 9	\$ (24)	\$ 1,417	
Home equity	1,014	36	15	32	1,097	—	(46)	1,051	
Consumer and other	185	3	—	—	188	2	(4)	186	
Total loans receivable	<u>\$ 2,468</u>	<u>\$ 98</u>	<u>\$ 37</u>	<u>\$ 114</u>	<u>\$ 2,717</u>	<u>\$ 11</u>	<u>\$ (74)</u>	<u>\$ 2,654</u>	

At December 31, 2017, the Company had loans with a carrying value of \$17 million classified as held for sale. These loans were presented within other assets as of December 31, 2017 and were sold during the three months ended March 31, 2018.

At March 31, 2018, the Company pledged \$2.1 billion and \$0.2 billion of loans as collateral to the FHLB and Federal Reserve Bank of Richmond, respectively. At December 31, 2017, the Company pledged \$2.2 billion and \$0.2 billion of loans as collateral to the FHLB and Federal Reserve Bank of Richmond, respectively.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

### 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. The following tables present the distribution of the Company's mortgage loan portfolios by credit quality indicator (dollars in millions):

<b>Current LTV/CLTV<sup>(1)</sup></b>	<b>One- to Four-Family</b>		<b>Home Equity</b>	
	<b>March 31, 2018</b>	<b>December 31, 2017</b>	<b>March 31, 2018</b>	<b>December 31, 2017</b>
<=80%	\$ 978	\$ 1,031	\$ 509	\$ 531
80%-100%	221	256	273	291
100%-120%	91	91	158	176
>120%	49	54	86	99
Total mortgage loans receivable	\$ 1,339	\$ 1,432	\$ 1,026	\$ 1,097
Average estimated current LTV/CLTV <sup>(2)</sup>	69%	70%	83%	84%
Average LTV/CLTV at loan origination <sup>(3)</sup>	71%	71%	82%	81%

- (1) Current CLTV calculations for home equity loans are based on the maximum available line for HELOCs and outstanding principal balance for HEILs. 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, HEILs and the maximum available line for HELOCs.

<b>Current FICO</b>	<b>One- to Four-Family</b>		<b>Home Equity</b>	
	<b>March 31, 2018</b>	<b>December 31, 2017</b>	<b>March 31, 2018</b>	<b>December 31, 2017</b>
>=720	\$ 749	\$ 805	\$ 509	\$ 548
719 - 700	126	138	98	106
699 - 680	105	105	89	93
679 - 660	76	78	72	79
659 - 620	111	122	102	103
<620	172	184	156	168
Total mortgage loans receivable	\$ 1,339	\$ 1,432	\$ 1,026	\$ 1,097

One- to four-family loans include loans with an interest-only period, followed by an amortizing period. At March 31, 2018, nearly 100% of these loans were amortizing. The home equity loan portfolio consists of HEILs and HELOCs. HEILs are primarily 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. At March 31, 2018, nearly 100% of the HELOC portfolio had converted from the interest-only draw period.

The weighted average age of our mortgage and consumer loans receivable was 12.1 years and 11.8 years at March 31, 2018 and December 31, 2017, respectively. Approximately 33% and 34% of the Company's mortgage loans receivable were concentrated in California at March 31, 2018 and December 31, 2017, respectively. No other state had concentrations of mortgage loans that represented 10% or more of the Company's mortgage loans receivable at March 31, 2018 and December 31, 2017.

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At March 31, 2018, 29% and 17% of the Company's past-due mortgage loans were concentrated in California and New York, respectively. No other state had concentrations of past-due mortgage loans that represented 10% or more of the Company's past-due mortgage loans. At March 31, 2018, 44% of the Company's impaired mortgage loans were concentrated in California. No other state had concentrations of impaired mortgage loans that represented 10% or more of the Company's impaired mortgage loans.

### Nonperforming Loans

The Company classifies loans as nonperforming when they are no longer accruing interest. The following table presents nonperforming loans by loan portfolio (dollars in millions):

	<b>March 31, 2018</b>	<b>December 31, 2017</b>
One- to four-family	\$ 179	\$ 192
Home equity	90	98
Consumer and other	1	—
Total nonperforming loans receivable	<u>\$ 270</u>	<u>\$ 290</u>

At March 31, 2018 and December 31, 2017, the Company held \$22 million and \$26 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 \$86 million and \$101 million of loans for which formal foreclosure proceedings were in process at March 31, 2018 and December 31, 2017, respectively.

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### 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 (dollars in millions):

	One- to Four-Family		Home Equity		Consumer and other		Total	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
General reserve:								
Quantitative component	\$ 11	\$ 15	\$ 5	\$ 14	\$ 3	\$ 4	\$ 19	\$ 33
Qualitative component	3	3	2	3	—	—	5	6
Specific valuation allowance	6	6	28	29	—	—	34	35
Total allowance for loan losses	<u>\$ 20</u>	<u>\$ 24</u>	<u>\$ 35</u>	<u>\$ 46</u>	<u>\$ 3</u>	<u>\$ 4</u>	<u>\$ 58</u>	<u>\$ 74</u>
Allowance as a % of loans receivable <sup>(1)</sup>	1.5%	1.6%	3.4%	4.2%	1.8%	2.1%	2.3%	2.7%

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

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

<b>Three Months Ended March 31, 2018</b>				
	<b>One- to Four-Family</b>	<b>Home Equity</b>	<b>Consumer and other</b>	<b>Total</b>
Allowance for loan losses, beginning of period	\$ 24	\$ 46	\$ 4	\$ 74
Provision (benefit) for loan losses	(5)	(16)	—	(21)
Charge-offs	—	—	(1)	(1)
Recoveries	1	5	—	6
Net (charge-offs) recoveries	1	5	(1)	5
Allowance for loan losses, end of period	\$ 20	\$ 35	\$ 3	\$ 58

<b>Three Months Ended March 31, 2017</b>				
	<b>One- to Four-Family</b>	<b>Home Equity</b>	<b>Consumer and other</b>	<b>Total</b>
Allowance for loan losses, beginning of period	\$ 45	\$ 171	\$ 5	\$ 221
Provision (benefit) for loan losses	—	(15)	1	(14)
Charge-offs	—	—	(2)	(2)
Recoveries	1	6	1	8
Net (charge-offs) recoveries	1	6	(1)	6
Allowance for loan losses, end of period	\$ 46	\$ 162	\$ 5	\$ 213

Total loans receivable designated as held-for-investment decreased \$148 million during the three months ended March 31, 2018. The allowance for loan losses was \$58 million, or 2.3% of total loans receivable, as of March 31, 2018 compared to \$74 million, or 2.7% of total loans receivable, as of December 31, 2017. Net recoveries for the three months ended March 31, 2018 were \$5 million compared to \$6 million in the same period in 2017.

The benefit for loan losses was \$21 million for the three months ended March 31, 2018. The timing and magnitude of the provision (benefit) for loan losses is affected by many factors that could result in variability. These benefits reflected better than expected performance of our portfolio as well as recoveries in excess of prior expectations, including recoveries of previous charge-offs that were not included in our loss estimates.



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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 portfolio (dollars in millions):

	Recorded Investment		Allowance for Loan Losses	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
Collectively evaluated for impairment:				
One- to four-family	\$ 1,140	\$ 1,228	\$ 14	\$ 18
Home equity	867	932	7	17
Consumer and other	191	190	3	4
Total collectively evaluated for impairment	2,198	2,350	24	39
Individually evaluated for impairment:				
One- to four-family	207	213	6	6
Home equity	159	165	28	29
Total individually evaluated for impairment	366	378	34	35
Total	\$ 2,564	\$ 2,728	\$ 58	\$ 74

### Impaired Loans—Troubled Debt Restructurings

Delinquency status is the primary measure the Company uses to evaluate the performance of loans modified as TDRs. The Company classifies loans as nonperforming when they are no longer accruing interest. 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.

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The following table presents 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 (dollars in millions):

		Nonaccrual TDRs				Total Recorded Investment in TDRs <sup>(3)(4)</sup>
	Accrual TDRs <sup>(1)</sup>	Current <sup>(2)</sup>	30-89 Days Delinquent	90-179 Days Delinquent	180+ Days Delinquent	
<b><u>March 31, 2018</u></b>						
One- to four-family	\$ 83	\$ 74	\$ 15	\$ 5	\$ 30	\$ 207
Home equity	100	30	9	6	14	159
Total	<u>\$ 183</u>	<u>\$ 104</u>	<u>\$ 24</u>	<u>\$ 11</u>	<u>\$ 44</u>	<u>\$ 366</u>
<b><u>December 31, 2017</u></b>						
One- to four-family	\$ 83	\$ 74	\$ 13	\$ 5	\$ 38	\$ 213
Home equity	104	34	10	4	13	165
Total	<u>\$ 187</u>	<u>\$ 108</u>	<u>\$ 23</u>	<u>\$ 9</u>	<u>\$ 51</u>	<u>\$ 378</u>

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

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

(3) Total recorded investment in TDRs includes premium (discount), as applicable, and is net of charge-offs, which were \$65 million and \$140 million for one-to four-family and home equity loans, respectively, as of March 31, 2018 and \$67 million and \$144 million, respectively, as of December 31, 2017.

(4) Total recorded investment in TDRs at March 31, 2018 consisted of \$277 million of loans modified as TDRs and \$89 million of loans that have been charged off due to bankruptcy notification. Total recorded investment in TDRs at December 31, 2017 consisted of \$285 million of loans modified as TDRs and \$93 million of loans that have been charged off due to bankruptcy notification.

The following table presents the average recorded investment and interest income recognized both on a cash and accrual basis for the Company's TDRs (dollars in millions):

	Average Recorded Investment		Interest Income Recognized	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2018	2017	2018	2017
One- to four-family	\$ 210	\$ 241	\$ 2	\$ 3
Home equity	165	192	4	4
Total	<u>\$ 375</u>	<u>\$ 433</u>	<u>\$ 6</u>	<u>\$ 7</u>

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The following table presents detailed information related to the Company's TDRs and specific valuation allowances (dollars in millions):

	March 31, 2018			December 31, 2017		
	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	\$ 54	\$ 6	\$ 48	\$ 54	\$ 6	\$ 48
Home equity	\$ 83	\$ 28	\$ 55	\$ 83	\$ 29	\$ 54
Without a recorded allowance: <sup>(1)</sup>						
One- to four-family	\$ 153	\$ —	\$ 153	\$ 159	\$ —	\$ 159
Home equity	\$ 76	\$ —	\$ 76	\$ 82	\$ —	\$ 82
Total:						
One- to four-family	\$ 207	\$ 6	\$ 201	\$ 213	\$ 6	\$ 207
Home equity	\$ 159	\$ 28	\$ 131	\$ 165	\$ 29	\$ 136

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

The following table presents the number of loans and post-modification balances immediately after being modified by major class (dollars in millions):

		Interest Rate Reduction				
	Number of Loans	Re-age/ Extension/ Interest Capitalization	Other with Interest Rate Reduction	Other <sup>(1)</sup>	Total	
<b>March 31, 2018</b>						
One- to four-family	16	\$ 6	\$ —	\$ 2	\$ 8	
Home equity	44	2	—	—	2	
Total	60	\$ 8	\$ —	\$ 2	\$ 10	
<b>March 31, 2017</b>						
One- to four-family	8	\$ 2	\$ —	\$ —	\$ 2	
Home equity	161	3	—	8	11	
Total	169	\$ 5	\$ —	\$ 8	\$ 13	

(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.

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**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 presents a summary of the fair value of derivatives as reported in the consolidated balance sheet (dollars in millions):

		Fair Value		
	Notional	Asset <sup>(1)</sup>	Liability <sup>(2)</sup>	Net <sup>(3)</sup>
<b><u>March 31, 2018</u></b>				
Interest rate contracts:				
Fair value hedges	\$ 10,086	\$ 4	\$ —	\$ 4
Total derivatives designated as hedging instruments <sup>(4)</sup>	\$ 10,086	\$ 4	\$ —	\$ 4
<b><u>December 31, 2017</u></b>				
Interest rate contracts:				
Fair value hedges	\$ 8,609	\$ 131	\$ (14)	\$ 117
Total derivatives designated as hedging instruments <sup>(4)</sup>	\$ 8,609	\$ 131	\$ (14)	\$ 117

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

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

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

(4) All derivatives were designated as hedging instruments at March 31, 2018 and December 31, 2017.

In January 2017, one of the two central clearing organizations through which the Company executes certain of its derivative contracts amended its rulebooks to legally characterize variation margin payments as settlements of the derivatives' exposure rather than collateral against the exposure. In January 2018, the other central clearing organization made similar rulebook amendments. 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. Accordingly, the consolidated balance sheet and the table above exclude derivative assets of \$381 million and \$6 million at March 31, 2018 and December 31, 2017, respectively, and derivative liabilities of \$13 million and \$18 million at March 31, 2018 and December 31, 2017, respectively, that were executed through a central clearing organization and were settled by variation margin payments. The Company therefore had no centrally cleared derivative contract assets or liabilities reflected on the consolidated balance sheet as a result of the rulebook changes as of March 31, 2018. At December 31, 2017, the Company had \$131 million and \$9 million of centrally cleared derivative contract assets and liabilities, respectively, reflected on the consolidated balance sheet.

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## Fair Value Hedges

The Company utilizes fair value hedges to offset exposure to changes in value of certain fixed-rate assets. All of the Company's derivative instruments were designated in fair value hedging relationships at March 31, 2018 and December 31, 2017. For each fair value hedge, both the gain or loss on the derivative, including periodic cash settlement accruals, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings. 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 item is amortized to net interest income using the effective interest method over the expected remaining life of the hedged item.

Beginning January 1, 2018, the net earnings impact of a fair hedge that is not perfectly effective is recognized in the interest income line item in the consolidated statement of income. Prior to January 1, 2018, the net earnings impact due to changes in fair value of the derivative and the hedged item, which was previously referred to as ineffectiveness, is reflected in the gains on securities and other, net line item in the consolidated statement of income. The earnings impact of periodic cash settlements accruals on the derivative is reflected in the interest income line item in the consolidated statement of income.

The following table presents the effects of fair value hedge accounting on the consolidated statement of income for the three months ended March 31, 2018 (dollars in millions):

	<b>Interest Income</b>
Total interest income	\$ 468
<b>Effects of fair value hedging on total interest income<sup>(1)</sup></b>	
Agency debentures:	
Amounts recognized as interest settlements on derivatives	(2)
Changes in fair value of hedged items	(50)
Changes in fair value of derivatives	49
Net loss on fair value hedging relationships - agency debentures	(3)
Agency mortgage backed securities:	
Amounts recognized as interest settlements on derivatives	(13)
Amortization of basis adjustments from discontinued hedges	2
Changes in fair value of hedged items	(231)
Changes in fair value of derivatives	229
Net loss on fair value hedging relationships - agency mortgage backed securities	(13)
Total net loss on fair value hedging relationships	\$ (16)

(1) Excludes interest income accruals on hedged items and amounts recognized upon the sale of securities attributable to fair value hedge accounting.

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The following table presents the changes in fair value of interest rate derivative contracts designated as fair value hedges and related hedged items as reflected in the consolidated statement of income for the three months ended March 31, 2017 (dollars in millions):

	Hedging Instrument	Hedged Item	Hedge Ineffectiveness <sup>(1)</sup>
Agency debentures	\$ 11	\$ (11)	\$ —
Agency mortgage-backed securities	13	(14)	(1)
Total gains (losses) included in earnings	\$ 24	\$ (25)	\$ (1)

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

The following table presents the cumulative basis adjustments related to the carrying amount of hedged assets in fair value hedging relationships (dollars in millions):

	Carrying Amount of Hedged Assets <sup>(1)</sup>	Cumulative Amount of Fair Value Hedging Basis Adjustment Included in Carrying Amount of Hedged Assets <sup>(2)</sup>	
		Total	Discontinued
<b>March 31, 2018</b>			
Available-for-sale securities	\$ 12,090	\$ (320)	\$ (215)

(1) The carrying amount includes the impact of basis adjustments on active fair value hedges and the impact of basis adjustments from previously discontinued fair value hedges.

(2) Represents the increase (decrease) to the carrying amount of hedged assets. The discontinued portion of the cumulative amount of fair value hedging basis adjustments is amortized into net interest income using the effective interest method over the expected remaining life of the hedged items.

The following table presents the hedging relationships designated under the last-of-layer method (dollars in millions):

	Carrying Amount of Hedged Assets <sup>(1)</sup>	Amount Representing Hedged Items Designated as Last-of-Layer	Basis Adjustment Associated with Hedged Items Designated as Last- of-Layer <sup>(2)</sup>
<b>March 31, 2018</b>			
<b>Fair value hedges under last-of-layer</b>			
Hedged item <sup>(3)</sup>	\$ 910	\$ 440	\$ 1

(1) The carrying amount includes the impact of basis adjustments on active fair value hedges.

(2) Represents the increase (decrease) to the carrying amount of hedged assets.

(3) Represents closed portfolios of prepayable securities designated in hedging relationships in which the hedged item is the last layer of principal expected to be remaining throughout the hedge term.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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**NOTE 8—DEPOSITS**


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The following table presents the significant components of deposits (dollars in millions):

	Amount		Weighted-Average Rate	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
Sweep deposits	\$ 37,927	\$ 37,734	0.07%	0.01%
Savings deposits	2,797	2,912	0.01%	0.01%
Other deposits <sup>(1)</sup>	2,178	2,096	0.02%	0.03%
Total deposits	<u>\$ 42,902</u>	<u>\$ 42,742</u>	0.07%	0.01%

(1) Includes checking deposits, money market deposits and certificates of deposit. As of March 31, 2018 and December 31, 2017, the Company had \$214 million and \$207 million in non-interest bearing deposits, respectively.

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**NOTE 9—OTHER BORROWINGS**


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The following table presents the significant components of other borrowings (dollars in millions):

	March 31, 2018	December 31, 2017
FHLB advances	\$ 500	\$ 500
Trust preferred securities <sup>(1)</sup>	410	410
Total other borrowings	<u>\$ 910</u>	<u>\$ 910</u>

(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 March 31, 2018 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 three unaffiliated banks aggregating to \$125 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 March 31, 2018.

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## **NOTE 10—CORPORATE DEBT**

The following table presents the significant components of corporate debt (dollars in millions):

	Face Value	Discount	Net
<b>March 31, 2018</b>			
Interest-bearing notes:			
2.95% Notes, due 2022	\$ 600	\$ (4)	\$ 596
3.80% Notes, due 2027	400	(4)	396
Total corporate debt	<u>\$ 1,000</u>	<u>\$ (8)</u>	<u>\$ 992</u>
<b>December 31, 2017</b>			
Interest-bearing notes:			
2.95% Notes, due 2022	\$ 600	\$ (5)	\$ 595
3.80% Notes, due 2027	400	(4)	396
Total corporate debt	<u>\$ 1,000</u>	<u>\$ (9)</u>	<u>\$ 991</u>

### **Credit Facility**

In 2017, the Company entered into an unsecured committed revolving credit facility with certain lenders, which replaced the previous secured committed revolving credit facility entered into in 2014 and increased the Company's 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 credit facility has terms which include financial maintenance covenants, with which the Company was in compliance at March 31, 2018. The unsecured committed revolving credit facility will mature on June 23, 2020. At March 31, 2018, there was no outstanding balance under this revolving credit facility.

## **NOTE 11—SHAREHOLDERS' EQUITY**

### **Preferred Stock**

The following table presents the preferred stock outstanding (in millions except total shares outstanding and per share data):

Description	Issuance Date	Per Annum Dividend Rate	Total Shares Outstanding	Liquidation Preference per Share	Carrying Value at	
					March 31, 2018	December 31, 2017
<b>Series A</b>						
Fixed-to-Floating Rate Non-Cumulative	8/25/2016	5.875% to, but excluding, 9/15/2026; 3-mo LIBOR + 4.435% thereafter	400,000	\$ 1,000	\$ 394	\$ 394
<b>Series B</b>						
Fixed-to-Floating Rate Non-Cumulative	12/6/2017	5.30% to, but excluding, 3/15/2023; 3-mo LIBOR + 3.16% thereafter	3,000	\$ 100,000	295	295
<b>Total</b>			<u>403,000</u>		<u>\$ 689</u>	<u>\$ 689</u>



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The following table presents the cash dividend paid on preferred stock (in millions except per share data):

Three Months Ended March 31, 2018					Three Months Ended March 31, 2017				
Declaration Date	Record Date	Payment Date	Dividend per Share	Dividend Paid	Declaration Date	Record Date	Payment Date	Dividend per Share	Dividend Paid
<b>Series A <sup>(1)</sup></b>									
2/8/2018	2/28/2018	3/15/2018	\$ 29.38	\$ 12	2/2/2017	2/28/2017	3/15/2017	\$ 32.64	\$ 13

(1) Dividends are non-cumulative and payable semi-annually.

## 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. During the three months ended March 31, 2018, the Company repurchased 2.7 million shares of common stock at an average price of \$52.12 for a total of \$140 million. As of March 31, 2018, the Company had repurchased a total of \$502 million, or 11.2 million shares of common stock under this program. As of March 31, 2018, \$498 million remained available for additional repurchases. As of April 30, 2018, the Company has subsequently repurchased an additional 0.9 million shares of common stock at an average price of \$60.01. The Company accounts for share repurchases retired after repurchase by allocating the excess repurchase price over par to additional paid-in-capital.

## Accumulated Other Comprehensive Loss

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

	Total <sup>(1)</sup>
Balance, December 31, 2017	\$ (26)
Other comprehensive loss before reclassifications	(128)
Amounts reclassified from accumulated other comprehensive loss	(7)
Transfer of held-to-maturity securities to available-for-sale securities <sup>(2)</sup>	6
Net change	(129)
Cumulative effect of hedge accounting adoption	(7)
Reclassification of tax effects due to federal tax reform	(14)
Balance, March 31, 2018 <sup>(3)</sup>	\$ (176)

(1) During the three month ended March 31, 2018, the accumulated other comprehensive loss activity related to available-for-sale securities.

(2) Securities with a carrying value of \$4.7 billion and related unrealized pre-tax gain of \$7 million, or \$6 million net of tax, were transferred from held-to-maturity securities to available-for-sale securities during the three months ended March 31, 2018, as part of a one-time transition election for early adopting the new derivatives and hedge accounting guidance. See Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies for additional information.

(3) Includes unamortized unrealized pre-tax losses of \$24 million at March 31, 2018 of which \$18 million is related to the transfer of available-for-sale securities to held-to-maturity securities during the three months ended March 31, 2018.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

	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)

The following table presents other comprehensive income (loss) activity and the related tax effect (dollars in millions):

	Three Months Ended March 31,					
	2018			2017		
	Before Tax	Tax Effect	After Tax	Before Tax	Tax Effect	After Tax
Other comprehensive income (loss)						
Available-for-sale securities:						
Unrealized gains (losses), net	\$ (172)	\$ 44	\$ (128)	\$ 76	\$ (30)	\$ 46
Reclassification into earnings, net	(10)	3	(7)	(8)	3	(5)
Transfer of held-to-maturity securities to available-for-sale securities	7	(1)	6	—	—	—
Net change from available-for-sale securities	(175)	46	(129)	68	(27)	41
Reclassification of foreign currency translation gains	—	—	—	(2)	—	(2)
Other comprehensive income (loss)	\$ (175)	\$ 46	\$ (129)	\$ 66	\$ (27)	\$ 39

The following table presents the consolidated statement of income line items impacted by reclassifications out of accumulated other comprehensive loss (dollars in millions):

Accumulated Other Comprehensive Loss Components	Amounts Reclassified from Accumulated Other Comprehensive Loss		Affected Line Items in the Consolidated Statement of Income
	Three Months Ended March 31,		
	2018	2017	
Available-for-sale securities:	\$ 11	\$ 8	Gains on securities and other, net
	(1)	—	Interest income
	10	8	Reclassification into earnings, before tax
	(3)	(3)	Income tax expense
	\$ 7	\$ 5	Reclassification into earnings, net
Foreign currency translation:	\$ —	\$ 2	Other non-interest expenses
	\$ —	\$ 2	Reclassification into earnings, net

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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**NOTE 12—EARNINGS PER SHARE**


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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 March 31,	
	2018	2017
Net income	\$ 247	\$ 145
Preferred stock dividends	12	13
Net income available to common shareholders	<u>\$ 235</u>	<u>\$ 132</u>
Share data (in thousands):		
Basic weighted-average shares outstanding	266,558	274,876
Effect of weighted-average dilutive securities:		
Restricted stock and options	1,124	1,109
Convertible debentures	17	292
Diluted weighted-average shares outstanding <sup>(1)</sup>	<u>267,699</u>	<u>276,277</u>
Basic earnings per common share	<u>\$ 0.88</u>	<u>\$ 0.48</u>
Diluted earnings per common share <sup>(1)</sup>	<u>\$ 0.88</u>	<u>\$ 0.48</u>

(1) The amount of certain restricted stock and options excluded from the calculations of diluted earnings per share due to the anti-dilutive effect was not material for the three months ended March 31, 2018 and 2017.

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**NOTE 13—REGULATORY REQUIREMENTS**


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**Broker-Dealer and FCM Capital Requirements**

The Company's US broker-dealer, E\*TRADE Securities, is 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 2/3% of its aggregate indebtedness, as defined, or a minimum dollar amount. E\*TRADE Securities has elected the Alternative method, under which it is required to maintain net capital equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions. The Company's international broker-dealer subsidiary is subject to capital requirements determined by its respective regulator.

The Company's FCM, E\*TRADE Futures, is 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, or (3) the amount of adjusted net capital required by the NFA.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

At March 31, 2018 and December 31, 2017, all of the Company's broker-dealer and FCM subsidiaries met minimum net capital requirements. The following table presents a summary of the minimum net capital requirements and excess capital for the Company's broker-dealer and FCM subsidiaries (dollars in millions):

	Required Net Capital	Net Capital	Excess Net Capital
<b>March 31, 2018:</b>			
E*TRADE Securities <sup>(1)</sup>	\$ 240	\$ 1,283	\$ 1,043
E*TRADE Futures	1	26	25
International broker-dealer	—	19	19
Total	\$ 241	\$ 1,328	\$ 1,087
<b>December 31, 2017:</b>			
E*TRADE Securities	\$ 211	\$ 1,213	\$ 1,002
E*TRADE Futures	4	19	15
International broker-dealer	—	19	19
Total	\$ 215	\$ 1,251	\$ 1,036

(1) E\*TRADE Securities paid dividends of \$125 million to the parent company during the three months ended March 31, 2018 and \$100 million in May 2018.

### Bank Capital Requirements

E\*TRADE Financial and its bank subsidiaries, E\*TRADE Bank and E\*TRADE Savings 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 the financial condition and results of operations of these entities. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, these entities 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, the Company's bank subsidiaries may not pay dividends to the parent company without the non-objection, or in certain cases the approval, of their regulators, and any loans by the bank subsidiaries to the parent company and its other non-bank subsidiaries are subject to various quantitative, arm's length, collateralization and other requirements. The capital amounts and classifications of these entities are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

Quantitative measures established by regulation to ensure capital adequacy require these entities 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 their ability to meet future capital requirements. E\*TRADE Financial, E\*TRADE Bank and E\*TRADE Savings Bank were categorized as "well capitalized" under the regulatory framework for prompt corrective action for the periods presented in the following table (dollars in millions):

	March 31, 2018					December 31, 2017				
	Actual		Well Capitalized Minimum Capital		Excess Capital	Actual		Well Capitalized Minimum Capital		Excess Capital
	Amount	Ratio	Amount	Ratio	Amount	Amount	Ratio	Amount	Ratio	Amount
<b>E*TRADE Financial<sup>(1)</sup></b>										
Tier 1 leverage	\$ 4,493	7.3%	\$ 3,096	5.0%	\$ 1,397	\$ 4,386	7.4%	\$ 2,976	5.0%	\$ 1,410
Common equity Tier 1 capital	\$ 3,804	35.0%	\$ 706	6.5%	\$ 3,098	\$ 3,773	33.9%	\$ 722	6.5%	\$ 3,051
Tier 1 risk-based capital	\$ 4,493	41.4%	\$ 868	8.0%	\$ 3,625	\$ 4,386	39.5%	\$ 889	8.0%	\$ 3,497
Total risk-based capital	\$ 4,965	45.7%	\$ 1,086	10.0%	\$ 3,879	\$ 4,874	43.8%	\$ 1,111	10.0%	\$ 3,763
<b>E*TRADE Bank<sup>(1)</sup></b>										
Tier 1 leverage	\$ 3,793	7.6%	\$ 2,498	5.0%	\$ 1,295	\$ 3,620	7.6%	\$ 2,394	5.0%	\$ 1,226
Common equity Tier 1 capital	\$ 3,793	37.4%	\$ 659	6.5%	\$ 3,134	\$ 3,620	35.7%	\$ 660	6.5%	\$ 2,960
Tier 1 risk-based capital	\$ 3,793	37.4%	\$ 811	8.0%	\$ 2,982	\$ 3,620	35.7%	\$ 812	8.0%	\$ 2,808
Total risk-based capital	\$ 3,851	38.0%	\$ 1,013	10.0%	\$ 2,838	\$ 3,694	36.4%	\$ 1,015	10.0%	\$ 2,679
<b>E*TRADE Savings Bank<sup>(1)</sup></b>										
Tier 1 leverage	\$ 1,522	30.4%	\$ 250	5.0%	\$ 1,272	\$ 904	26.6%	\$ 170	5.0%	\$ 734
Common equity Tier 1 capital	\$ 1,522	145.6%	\$ 68	6.5%	\$ 1,454	\$ 904	111.1%	\$ 53	6.5%	\$ 851
Tier 1 risk-based capital	\$ 1,522	145.6%	\$ 84	8.0%	\$ 1,438	\$ 904	111.1%	\$ 65	8.0%	\$ 839
Total risk-based capital	\$ 1,522	145.6%	\$ 105	10.0%	\$ 1,417	\$ 905	111.2%	\$ 81	10.0%	\$ 824

(1) Basel III includes 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. See *Part I. Item 1. Business—Regulation in our Annual Report on Form 10-K* for the year ended December 31, 2017 for additional information.

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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

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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. The trial court subsequently denied Ajaxo's requests for additional damages and relief following which Ajaxo appealed. Although the Company paid Ajaxo the full amount due on the above-described judgment, the case was remanded back to the trial court by the California Court of Appeal, 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. After various appeals the case was again remanded back to the trial court. Following the third trial in this matter, 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. The Company will continue to defend itself vigorously in this matter.

On May 16, 2011, Droplets Inc., the holder of two patents pertaining to user interface servers, filed a complaint in the US 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. The plaintiff contends that the defendants engaged in patent infringement under federal law and 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 US 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). After a hearing, the PTAB deemed Droplets' putative '115 patent to be "unpatentable" on June 23, 2016. In a separate proceeding, the PTAB has also separately deemed Droplets' putative '838 patent to be "unpatentable." Droplets appealed to the Circuit Court of Appeals for the District of Columbia. The decision of the PTAB was affirmed on April 19, 2018. The Company will continue to defend itself vigorously in this matter.

On March 26, 2015, a putative class action was filed in the US 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. The plaintiff seeks unspecified damages, declaratory relief, restitution, disgorgement of payments received by the Company, and attorneys' fees. On April 2, 2017, the District Court dismissed the complaint in *Rayner*. The plaintiffs in *Rayner* appealed and the oral argument was

**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

heard by the Second Court of Appeals on December 7, 2017. The Company will continue to defend itself vigorously in these matters.

On July 23, 2016, a putative class action was filed in the US 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, 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. The plaintiff seeks unspecified damages, declaratory relief, restitution, disgorgement of payments received by the Company, and attorneys' fees. By stipulation both matters are now venued in the Southern District of New York. On July 10, 2017 the Court dismissed the *Schwab* claims without prejudice. The plaintiff in *Schwab* filed a third amended complaint on August 9, 2017, which E\*TRADE moved to dismiss. On January 22, 2018, the Court dismissed all claims with prejudice. Plaintiffs have appealed. The Company will continue to defend itself vigorously in these matters.

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 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

**E\*TRADE FINANCIAL CORPORATION**  
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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 \$95 million in unfunded commitments with respect to these investments at March 31, 2018.

At March 31, 2018, the Company had \$19 million of certificates of deposit scheduled to mature in less than one year.

### **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 March 31, 2018, management estimated that the maximum potential liability under this arrangement, including the current carrying value of the trusts, was equal to \$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.



**E\*TRADE FINANCIAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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**NOTE 15—SUBSEQUENT EVENT**

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**Acquisition of Trust Company of America**

On April 9, 2018, the Company completed its previously announced acquisition of TCA for total consideration of \$275 million in cash. TCA is a leading provider of technology solutions and custody services to the independent RIA market. The acquisition is expected to benefit the Company as the RIA portion of our industry is growing and the Company expects to leverage the E\*TRADE brand to accelerate growth. The Company also expects this acquisition to help bolster the Company's ability to retain customers in need of specialized customer service engagement.

The operating results of the Company for the three months ended March 31, 2018 do not include the operating results related to TCA as the acquisition did not close until April 9, 2018. The initial accounting for the TCA acquisition has not been completed as of issuance date of these financial statements because the fair value measurement of assets acquired, liabilities assumed and goodwill has not yet been finalized. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the acquisition date.

## ITEM 4. CONTROLS AND PROCEDURES

- (a) Based on an evaluation under the supervision and with the participation of our management, our Chief Executive Officer and our Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.
- (b) There were no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2018, identified in connection with management's evaluation required by paragraph (d) of Exchange Act Rules 13a-15 and 15d-15, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II

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### 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, 2017.

### 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 March 31, 2018 (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 Program <sup>(3)</sup>	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Program <sup>(3)</sup>
January 1, 2018 - January 31, 2018	165	\$ 52.29	—	\$ 638
February 1, 2018 - February 28, 2018	2,133,700	\$ 51.50	1,799,200	\$ 547
March 1, 2018 - March 31, 2018	909,307	\$ 54.75	891,400	\$ 498
Total	3,043,172	\$ 52.47	2,690,600	

(1) Includes 352,572 shares withheld to satisfy tax withholding obligations associated with restricted shares.

(2) Excludes commission paid, if any.

(3) 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.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS

Exhibit Number	Description
*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

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\* Filed herewith.

## 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: May 3, 2018

E\*TRADE Financial Corporation  
(Registrant)

By /S/ KARL A. ROESSNER

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Karl A. Roessner

**Chief Executive Officer**

(Principal Executive Officer)

By /S/ MICHAEL A. PIZZI

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**Michael A. Pizzi**

**Chief Financial Officer**

(Principal Financial Officer)

By /S/ BRENT B. SIMONICH

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**Brent B. Simonich**

**Corporate Controller**

**(Principal Accounting Officer)**

1. I have reviewed this Quarterly Report on Form 10-Q of E\*TRADE Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

E\*TRADE Financial Corporation  
(Registrant)

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

1. I have reviewed this Quarterly Report on Form 10-Q of E\*TRADE Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

E\*TRADE Financial Corporation  
(Registrant)

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

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

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

Karl A. Roessner, the Chief Executive Officer and Michael A. Pizzi, the Chief Financial Officer of E\*TRADE Financial Corporation, each certifies that, to the best of their knowledge:

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

Dated: May 3, 2018

/S/ KARL A. ROESSNER

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Karl A. Roessner  
*Chief Executive Officer*  
*(Principal Executive Officer)*

/S/ MICHAEL A. PIZZI

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Michael A. Pizzi  
*Chief Financial Officer*  
*(Principal Financial Officer)*



