Company Name: **E*TRADE Financial Corp**
Company Ticker: **ETFC**
Sector: **Financial**
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Event Description: **Q1 2016 Earnings Call**
Market Cap as of Event Date: **6.93B**
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E Trade Financial (ETFC) Earnings Report: Q1 2016 Conference Call Transcript

The following E Trade Financial conference call took place on April 21, 2016, 05:00 PM ET. This is a transcript of that earnings call:

Company Participants

- Paul Idzik; E TRADE Financial Corporation; CEO
- Michael Pizzi; E TRADE Financial Corporation; CFO

Other Participants

- Rich Repetto; Sandler O'Neill & Partners; Analyst
- Conor Fitzgerald; Goldman Sachs; Analyst
- Chris Harris; Wells Fargo Securities, LLC; Analyst
- Steven Chubak; Nomura Securities Co, Ltd; Analyst
- Dan Fannon; Jefferies LLC; Analyst
- Devin Ryan; JMP Securities; Analyst
- Christian Bolu; Credit Suisse; Analyst
- Brian Bedell; Deutsche Bank; Analyst
- Michael Carrier; BoA Merrill Lynch; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Thank you for joining E TRADE Financial , please refer to our earnings release furnished with Form 8-K and our 10-Ks, 10-Qs, and other documents the Company has filed with the SEC. All of these documents are available at about.etrade.com.

This call will present information as of April 21, 2016. The Company disclaims any duty to update forward-looking statements made during the call. This call is being recorded and a replay will be available via phone and webcast later this evening at about.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

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

Paul Idzik (CEO):

Thank you, Ash. Good evening and thank you for joining us to reflect on what has been a meaningful quarter for ETRADE.

We kicked off the year with solid play by all our lines as we posted strong results and continued to roll out enhancements to our customer offering and deployed a considerable quantum of capital to shareholders.

Amidst the market environment characterized by trepidation and unease, we posted respectable growth in the business as our customers remained relatively active. Our results again benefited from the dwindling size and better-than-expected performance of our legacy loan portfolio and we made significant progress on our premeditated march towards of $50 billion balance sheet.

Meanwhile, we began managing the bank to a lower Tier 1 leverage ratio, distributed a considerable amount of capital to the parent, and continued to put capital to work for our owners.

Starting with our results, we reported net income of $153 million, or $0.53 per share for the quarter. On the metrics, customer activity increased sequentially, a trend that is typical in Q1. We also traditionally expect an uptick in activity from our corporate services customers in Q1 and that trend was less pronounced, attributable to the underperformance of the market.

Options contributed a steady 23% of total DARTs; additionally, the portion of trades executed by our mobile platforms held steady at 16%. And April to date, DARTs are tracking down 1% for March. In terms of sentiment, Q1 presented a bleak opening for our customers as the markets kicked off January with one of the worst starts in the history.

Confidence in activity improved through the quarter and by March end, it seemed a Cimmerian curtain had lifted. The sum total of this quarter's activity was solid, with our customers being net buyers of $1.2 billion of securities, while exhibiting some purposeful derisking behavior. Margin balances were dialed back by slightly over $1 billion, with balances averaging $6.7 billion and ending the period at $6.3 billion for the quarter. In April to date, balances are flat where they ended the quarter.

Meanwhile, we continue to post solid growth. Excluding the impact of shutting down our Hong Kong and Singapore operations, we added 45,000 net new brokerage accounts during the quarter, while our adjusted attrition rate improved to 7.3%, both of which represent our best quarterly marks in two years.

We added $2.9 billion of net new brokerage assets during the quarter, healthy for Q1 but down from $3.5 billion a year ago, primarily due to lower activity from our stock plan customers. Our focus on retirement, investing and savings is present in this metric, as one quarter of these flows were into retirement accounts.

Q1's results also included a $0.10 per share income tax benefit and some important changes to our reporting and segments, and Mr. Pizzi will elegantly walk you through each of those. There is one element I will highlight, however, which is the impact of these changes on our operating margin calculation, reducing it by about 2 percentage points, making our equivalent target 37% over this year.

Also, you'll find that we present this metric both straight up and adjusted, which excludes provision for loan losses this quarter, the latter being the measure to which we manage our spending. While we are ever mindful of the impact that provision can have on our bottom line and our capital, we don't view it as a key factor governing our investments in the business.

That said, a large benefit is not a license to spend nor would we ignore any meaningful charges. And with that context out of the way, we posted an adjusted operating margin of 34% in Q1, below our full-year target of 37%, yet broadly in line with our expectations given the timing of balance sheet growth and seasonality in comp and advertising.

The performance of the loan portfolio exceeded our expectations and our results included a net benefit in the charge-off line, oaf first for the Company. We continued to benefit from recoveries along with better-than-expected performance of HELOC conversions, which we are now more than halfway through. This diminishing portfolio ended the quarter at just $4.7 billion.

On to capital, where we delivered some remarkable numbers and progress this quarter across each stage of the capital lifecycle, generation, distribution and deployment. Talking about our generation of capital, we've done a lot, both from an earnings standpoint as well as through lower capital thresholds.

The progress we made acutely reflects our improved financial position and regulatory progress, which are proof positive of all the work the entire team has done on the enterprise risk management front, the enhancements we've made to our operations and leadership team, as well as the continued and marked improvement to our overall risk profile.

Concordant with our much improved stature is the freedom we've earned to internally distribute the capital we generate, continuing to benefit from improved flexibility at the bank and Company-wide. This quarter, we distributed a hefty $400 million to the parent, well above our typical contribution.

This includes capital from the bank, both formed through s earnings and liberated through the 100 basis point drop in our targeting leverage ratio and capital from our brokers, from the earnings of our introducing broker and the extraction of excess capital from our dealing broker.

One related element of note. While we've achieved a reduction in our bank leverage ratio to 8%, well ahead of our original plan, we have our sight set on continued improvement to our capital efficiency there and aim to manage closer to 7.5% in early 2017. This, of course, is our aspiration and would require regulatory approval.

On capital deployment, we exceeded $250 million in cumulative share repurchases during the quarter, putting us nearly halfway through our current authorization just a few months after embarking on the program. While market dislocations during the quarter presented us with opportunities to be aggressive buyers of our stock, we aim to continue buybacks at a more modest pace with an eye on completing the current $800 million program by year end.

We are devotees of buybacks, as they allow us to return capital to shareholders efficiently and with low risk. With regard to additional capital deployment we're progressing on growing our balance sheet to $49.5 billion, adding $2.5 billion during the period. We intend to reach our target size this quarter.

In exploring other avenues to put capital to work, we continue to focus on growth, with acquisition as one method to achieve that goal. This quarter, we sharpened our focus and would like to walk through our current thinking.

We believe scale acquisitions in the brokerage base make the most sense. We also look for opportunities to bolster our capabilities through acquisition and consideration of our retirement, investing and savings vertical, as well as our corporate services channel; however, we continually evaluate build versus buy on this front.

Specific to acquisitions in the banking space, our areas of focus include innovative financial technology within custody of payment services and trust and wealth management offerings to the extent we find a logical fit in support of our current strategy.

Now we certainly understand there's been significant investor interest around acquisitions that could result in credit exposure and would like to summarize our present thinking on this. The extent we would consider taking on credit exposure through acquisition, it would have to exceed a substantially higher hurdle for returns, to ensure the benefits and associated risks would truly be worthy of our owner's capital and management's time.

To make this point very clear, we will not explore acquisitions in a traditional banking model unless it is overwhelmingly compelling for shareholders. We have come too far as a Company to go around the bend by assuming unwarranted risk through an injudicious acquisition. We also continue to evaluate other options for capital deployment, including share repurchases beyond our current program and balance sheet growth beyond $50 billion.

Mr. Pizzi will provide color on how we measure these options. With respect to enhancements and rollouts, Q1 was a busy quarter. To cover a few of the highlights, we continue to expand our industry-leading mobile offerings as we incorporated customer feedback to increase customization capabilities on the mobile dashboard.

As mobile continues to become a channel for long-term investors, as much as for active traders, we also introduced a mobile retirement center, helping customers plan their retirement savings with a calculator tool and easily open an IRA or roll over an existing 401(k) account. On our website, we upgraded our income estimator tool, which now provides an improved logic that can be applied to securities within a watch list and can seamlessly send any stock, ETF, or mutual fund through for execution.

Most recently, we rolled out a new dashboard in ETRADE Pro, creating a home base for our most active traders to track the markets, manage their portfolios, and much more in a consolidated manner. We have a pipeline of great tools, features and new experiences in store for our customers this year, so stay tuned. I look forward to sharing more with you.

We have just emerged from our industry's award season with an ample assortment of accolades. Receiving high marks from Barron's and NerdWallet, nine best-in-class distinctions from stockbrokers.com, which includes earning the number one mobile app, three Gold Awards from Corporate Insight, and an honoree designation from the Webby Awards.

Our industry also witnessed one of the more impactful pieces of overreaching regulations seen in recent history. The Department of Labor's ruling on the applicability of fiduciary standard. First, I want to state unequivocally that we support efforts to advance the best interest of retail investors, and we'll work within the new regulatory guidelines to continue to deliver guidance on our customers' terms and provide services that help investors take control of their financial health.

We are also pleased with the DOL heeding many of the industry's concerns regarding the initial draft, delivering a final rule that is less burdensome than originally proposed. We believe as a matter of principle that all who serve the retail investors should be held to the highest standards when it comes to working in their best interest.

At the same time, we believe this pursuit must be balanced against ensuring investors continue to have seamless access to investment support and the greatest variety of financial choices at their disposal to help them trade, invest and save. We're still working through the rulings' significance but are confident will have minimal impact on our ability to properly serve our customers.

On the leadership front, I'm very pleased to welcome an addition to our executive suite, as we concluded our comprehensive search for a new Chief Risk Officer earlier this month, reporting Ms. Ellen Koebler to the post. With a risk management career spanning nearly two decades at a handful of large and complex financial institutions, Ellen brings considerable firepower to this crucial function into our executive committee.

As Ellen comes on board, our unassailable Acting CRO and the original architect of ETRADE's risk organization, Mr. Paul Brandow, has graciously agreed to stay on in an advisory capacity to me and the entire executive team. I'm happy to know we'll continue to benefit from his sage perspective and consummate insight.

In closing, as I think about 2016, we have a lot of exciting things in the works on the customer experience front and we'll continue to ruthlessly pursue the best path forward on capital deployment. I look forward to keeping you apprised. And with that, I will turn it over to our sedulous CFO, Mr. Pizzi.

Michael Pizzi (CFO):

Thank you, Mr. Idzik. For the quarter, we reported adjusted net income of $122 million, or $0.43 per share. This excludes $31 million, or a 10% per share tax benefit, related to the release of a valuation allowance against state deferred tax assets. Our results compare to $89 million, or $0.30 per share, in the prior quarter. It also compares to adjusted net income of $85 million, or $0.29 per share, in the year-ago quarter, which excludes the loss on early extinguishment of corporate debt.

Before I delve into the details of our income statement, I'd like to review the changes we made to our reporting this quarter. For those of you following along, these changes are laid out graphically in our quarterly financial supplement on about.etrade.com, under the Quarterly Earnings section. There, you will also find realigned financials going back through 2014.

I'll refer to those during this call. We consolidated our business segments and realigned both our income statement and yield table, all of which are reflective of how we currently manage the business. As for the specifics, beginning with segment reporting. We collapsed our operating segments and are now presenting only consolidated financial results.

With the vast majority of our legacy costs in the rear view mirror and the management of our balance sheet now focused solely on maximizing the value of customer deposits, we thought it was the right time to wave goodbye to the balance sheet management segment as well as the corporate category.

We also realigned our income statement, moving our below the line items into revenue and expenses. Most notable among those changes is that corporate interest expense is now included in net interest income.

Additionally, other income and expense was moved into the gains and losses on securities and other revenue line and losses on early extinguishment of debt are now included within the non-interest expense section. Taking a deeper dive into net interest income, we are now reporting net interest margin as opposed to spread. After all, most of you already call it NIM.

Now onto the results. Revenue for the quarter were $472 million, up from $439 million in the prior quarter, attributable to higher net interest income, as both net interest margin and balance sheet size increased sequentially and up from $441 million in the year-ago quarter, as a result of the termination of wholesale borrowings, the Fed rate hike, and the corporate debt reduction and refinance.

Net interest income of $287 million improved $17 million from the prior quarter, driven by a 7 basis point improvement in the net interest margin on the $1.4 billion larger average interest earning balance sheet. Our net interest margin of 281 basis points increased as a result of the full quarter impact of the Fed rate hike, coupled with slower prepayment speeds on the securities portfolio but was partially offset by lower margin balances.

Because we guided to spread on our last call, I'll tell you that based on our prior reporting, our spread for the quarter would have been 294 basis points, meaning we significantly outperformed our expectations of high 270s. As for our expectations for the full year, holding the Fed funds rate constant and doing the same to margin balances, we expect our net interest margin for the full year to be in the 260 to 265 basis point range.

Adjusted for the reporting changes, this is consistent with our previous guidance. Note that our significant outperformance in Q1 is offsetting our expectation for NIM to contract in the remainder of the year. For Q2, specifically, we expect it to land in the mid 260s. Commissions, fees, and service charges and other revenue were $175 million, up $15 million from the prior quarter and down just modestly versus the year-ago quarter.

Two main factors contributed to the fluctuations. First, customer activity increased 12% versus Q4 but decreased 3% versus the year-ago period and second, improved rates on off-balance sheet cash helped drive increases in fees and service charges, relative to both periods. On the latter, the average rate earned on off-balance sheet cash was 30 basis points in Q1, up 17 basis points from Q4 as a result of the full-quarter impact of the December rate hike.

Keep in mind this is a gross number, so net of the fees paid to our third-party platform administrator, we earned 24 basis points on average in the period. Average commission per trade of $10.64 declined $0.02 from the prior quarter and $0.30 from the year-ago quarter. The year-over-year decline was driven by lower contribution from stock plan customer trades and fewer options contracts per trade.

Securities and other gains were $10 million, flat with the prior quarter. For the full year, we expect gains to be in the $30 million to $40 million range. Non-interest expense for the quarter was $312 million, up $7 million from the prior quarter, which included $14 million in nonrecurring charges. Excluding those items, the $21 million sequential increase was driven primarily by compensation and benefits, which reflect the full-quarter impact of hires we made in Q4 as well as seasonality related to compensation.

We remain highly attuned to the operating environment and the impact it has on how we manage our expenses. As Paul mentioned, for the quarter, our adjusted operating margin was 34%. Our target for the year remains 37%, the equivalent of 39% prior to our reporting changes.

For Q2 specifically, we expect expenses to decrease approximately $10 million sequentially, primarily related to lower marketing spend. Provision for the quarter was a benefit of $34 million; needless to say, better than we expected. Net charge-offs were also positive at $3 million of recoveries, resulting in a $31 million reduction in the allowance to $322 million.

Meanwhile, the overall portfolio itself reduced by $284 million, or 6% to $4.7 billion. In addition to the positive impact of recoveries, our provision benefit also reflected better-than-expected performance on converted HELOCs that were previously classified as high risk and had been reserved for using the full life of loan loss expectation.

This includes balloon loans, of which there are just $25 million remaining, the vast majority of which will convert in the current quarter. In total, we had $213 million of HELOCs convert to amortizing loans during Q1, which puts us more than halfway through the conversions. Performance in Q1 was consistent with the observations we discussed last quarter, where the default rate on the converting loans is about twice that of a non-converting loans, at approximately 12%.

So while we have been presently surprised by performance to date, please keep in mind we have a sizable pipeline of conversions through Q1 of next year. For this, we have reason we expect our provision to be approximately zero, with the caveat that recoveries are greater than expected magnitude could again results in a provision benefit.

One final note on the P&L regarding the tax benefit we recorded this quarter. With the move of our broker-dealers behind us, we took a hard look at our organizational alignment and found an opportunity to reinstate the tax treatment of our broker-dealers prior to moving them under the bank.

The tax selection resulted in a release of valuation allowance against the associated state deferred tax assets. We're always looking for ways to deliver for shareholders and we are pleased to uncover additional value in this pursuit.

Moving on to capital, we distributed nearly $400 million up to the parent during the quarter, comprising the following $248 million from the bank, which included $97 million from the prior quarter's net income and $151 million as a result of our reduced bank leverage ratio; and $148 million from the brokers which included $24 million of excess capital generation at the introducing broker as well as $124 million from the clearing broker.

In the second quarter, we expect total dividends to the parent of approximately $190 million from the bank and brokers. Starting with the bank, since balance sheet growth consumes bank capital and directly impacts our leverage ratio, in Q2, we will request an $85 million dividend to the parent, which is below the prior quarter bank net income of $108 million.

From the introducing broker, we anticipate $27 million to the parent as part of the standard quarterly distribution and from the clearing broker, we plan to move $75 million. We continually assess the capital position of the entity and based on the business environment, we may periodically move surplus capital.

We remain in the midst of two capital deployment initiatives balance sheet growth and share repurchases. On the former, we expect to reach our targeted balance sheet size by the end of the current quarter. At that point, based on Q1 deposits, we would have $2 billion in off-balance sheet deposits available to onboard.

With respect to the cost of exceeding $50 billion, we completed additional work during the quarter and are initial estimate remains intact, which is $50 million over two years related to the build out, with an annual recurring component of roughly $15 million. So to justify these expenses, along with the capital required to be held against the assets, we need some combination of higher rates and an abundance of customer cash.

So for the time being, we plan to hold steady under the $50 billion mark. On share repurchases, as Paul highlighted, we are nearly halfway through the $800 million program, having picked up nearly 15 million shares at an average price of $23.81.

To elaborate on our internal parameters regarding utilizing capital for repurchases, while corporate cash is a clear measure of our dry-powder, we are also mindful of our consolidated Tier 1 leverage ratio, which we managed to a floor of 7%, meaning we would not utilize capital to the extent it would put us below this level. We ended the quarter with corporate cash of $482 million and consolidated Tier 1 leverage of 7.8%, which provides the ability to make substantial progress on our program.

With that, Operator, we will open the call for questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Rich Repetto with Sandler O'Neill.

Rich Repetto (Analyst - Sandler O'Neill & Partners):

Good evening, Paul. Good evening, Mike. I guess…

(Multiple Speakers)

Paul Idzik (CEO):

Hello, Rich. Always nice to hear doyen of the industry.

Rich Repetto (Analyst - Sandler O'Neill & Partners):

Thank you. The checking line definitely contributed here with the provision. I'm just trying to see -- you don't expect it to contribute like it did. And is the performance that you're seeing there -- I know we've still got half the amortization of the portfolio to go but are we still -- it just feels like we are conservative because given the last couple of quarters and the amount of reversals we have seen in that line.

Paul Idzik (CEO):

Well, Mike is going to talk to it in more detail but Rich, our models and what we have set aside goes through a tremendous amount of scrutiny, not only from our own people but from our accountancy firm and also from our regulators. So I just think we need to keep that in context as we think about it. But Mike, I know you have stuff to add here.

Michael Pizzi (CFO):

Rich, I would keep in mind that as we move through time, we are moving into later vintage loans, with the loans this year being -- really converting in 2006 vintage. Next year, it would be 2007, so the remaining 50% is of vintages that are largely thought to be of lower quality so that may help put this in perspective a little bit.

The other point I would call out is while we did have $3 million of recoveries through the charge-off line, they are not coming from the current loan population and so that elevated recovery number that we see, that's really been, really, very influential in the last few quarters is very difficult to forecast on a go-forward basis. And that's what contributes to coming out where we are in the current allowance.

Rich Repetto (Analyst - Sandler O'Neill & Partners):

Got it. Okay. Helpful, thank you. And then just, I'm going to ask about interest rate sensitivity and we looked at the presentation and it's hard to compare given the new -- the adjustments to the NII , but is there incremental, like, the spread in your presentation is wider. Has anything changed in regards to interest rate sensitivity?

Paul Idzik (CEO):

Very little change in regards to interest rate sensitivity. What I will say is given the movement in margin and the movements in cash and you'll see a higher amount of segregated cash, those are the items that are directly influencing the small change in the Delta in that interest income that you see.

Rich Repetto (Analyst - Sandler O'Neill & Partners):

Got it. Okay. And then I guess my last question is on -- great quarter. It seemed like you beat on every revenue line but margin loans did drop. It appears a little bit more than peers. Anything going on? I know you mentioned, Paul, deleveraging of the consumer. But can you give us some more color on a -- I guess it was, I think 15% quarter to quarter?

Paul Idzik (CEO):

Rich, you'll -- if you go back in history, you will see that while margin balances were building up, ours were building a little faster. And as our customer base decided to derisk, they derisked a little faster and a little more steeply than the competition so I think it's just a question of the make-up of the relative customer books.

Rich Repetto (Analyst - Sandler O'Neill & Partners):

Got it. Okay, that's all I had and congrats on a good quarter.

Paul Idzik (CEO):

Thank you Rich.

Operator:

Conor Fitzgerald with Goldman Sachs .

Conor Fitzgerald (Analyst - Goldman Sachs):

Good evening

Paul Idzik (CEO):

Hi, Conor.

Conor Fitzgerald (Analyst - Goldman Sachs):

So Paul, just want to go back your comments on, I think, managing the business to the adjusted pre-tax margin, so excluding the reserve release. I think on the last quarter call, you left the door open for maybe reinvesting reserve release if they were stronger than you expected back in the business. Should we interpret your comments today as reserve release is totally divorced from your expenses?

Paul Idzik (CEO):

No. I think what we said is we don't see it as a license to just spend it without regard to our other targets and other obligations we have, both to our owners and other things we are trying to accomplish. So that's what we're trying to point to as well as saying, if we have worse-than-expected charges that we would try and still keep to our target.

So that's -- I think what you're hearing us talk about, Conor, is just trying to continue to be as disciplined as we can and managing for the type of results that we think our owners deserve. (multiple speakers) If we thought we could put additional cash to work wisely, we'd be happy to tell you about that.

Conor Fitzgerald (Analyst - Goldman Sachs):

Got it. And then again on the buyback. I appreciate the comments around the timing and the 7% floor, but if you were to get kind of more aggressive, is it more in your mind, you just want to be more deliberate from hereon out? Or are you trying to maybe respond to share price movements when you think about the pace and the timing? Is it more steady or are you going to try to be a little more dynamic?

Paul Idzik (CEO):

Well, I think you saw an acceleration in the quarter; that was definitely in response to the market. I think we will remain as dynamic as we can be within the confines of our capital and corporate cash to respond to the overall market environment but as we said on the call, we see finishing this really within the year, really one quarter ahead of the authorization timing.

Conor Fitzgerald (Analyst - Goldman Sachs):

All right. Very helpful. Thank you.

Operator:

Chris Harris with Wells Fargo .

Chris Harris (Analyst - Wells Fargo Securities, LLC):

Thanks guys. Just wanted to come back to the NIM for a second. The $290 million or that you talked about -- $294 million, I guess it was for the quarter, what was it that happened that really surprised to the upside? Was it the flow-through on rates, the Fed rate hike being a little bit stronger than maybe you guys had anticipated? Is that what drove a lot of it? Just trying to square that relative to the original guidance?

Paul Idzik (CEO):

Well, the Fed rate hike did drive some of it but that was contemplated within the guidance. The main driver of outperformance versus the guidance really had to do with lower-than-expected, substantially lower-than-expected prepayment fees on the securities portfolio. And then you will see, that even though the margin balance declined, the rate is up more than what the Fed move would suggest, meaning the balances that left were at a much lower rate than the average for the portfolio.

Chris Harris (Analyst - Wells Fargo Securities, LLC):

Got you. Okay, I was going to ask a question on the margin loan, so that was good. All right. Ameritrade, on their call, they talked a little bit about some expenses for DOL. Any thoughts there, guys, whether you've kind of taken a look at that? I know we've really just gotten the final ruling out but anything you could help us there as far as perhaps magnitude or anything qualitatively as well?

Michael Pizzi (CFO):

I didn't listen to the TD Ameritrade call, but we anticipate being able to meet our DOL obligations within the target guidance we have given for operating margin. As we gone through and seen what's occurring out of the regs, we feel our model stands up very well with us not having proprietary product, us having compensation practices that are close to what's desired as it is. And so we're pretty confident we're going to be able to continue and try to drive towards our target operating margin.

Chris Harris (Analyst - Wells Fargo Securities, LLC):

Helpful. Thank you.

Operator:

Steven Chubak with Nomura.

Steven Chubak (Analyst - Nomura Securities Co, Ltd):

Hi, good evening

Michael Pizzi (CFO):

Hey Steven.

Steven Chubak (Analyst - Nomura Securities Co, Ltd):

I figure I'll kick these off with a question on capital ratios. You noted that you intend to request the incremental 50 basis point reduction in your targeted bank leverage to 7.5% next year. I just wanted to get a sense as to whether 7% is a reasonable end game target that you guys are still contemplating, which from your remarks, is consistent with what you're managing to at the parent today?

Paul Idzik (CEO):

Well, Steven, we do see others, in the industry, have a target -- have a 7% handle. And when Mike and I wistfully look across the horizon as the sun sets, our eyes do twinkle, thinking about the ability to get down to 7%. I think it's probably a reasonable aspiration we have.

And we will just continuing what we've been doing in terms of improving our risk profile, taking regulatory guidance, seriously working hard to keep strength in our enterprise risk management. And with all those things and with the close supervision of our regulators, we're hopeful that we'll be able to get down more towards where we see other competitors in a reasonable period of time.

Steven Chubak (Analyst - Nomura Securities Co, Ltd):

Understood. Well, thinking about that pro forma balance sheet always brings a twinkle in your eye, I know in the past, you have spoken about some potential benefits linked to a portfolio sales and recognizing there are some different puts and takes but given the favorable prior performance we've seen and now that you are halfway through the amortizing HELOCs, is that still an attractive avenue worth pursuing? And does the secondary market actually accommodate that at the moment?

Paul Idzik (CEO):

Well, right now, we still think that holding those assets is in our shareholders' best interest. We, of course, continue to take soundings in the market and if we felt a better solution would be to sell those to other people, we would certainly do so and you have my phone number and if you want to buy them, Steven, you just give us a call and we will talk about it at some point.

Steven Chubak (Analyst - Nomura Securities Co, Ltd):

Unfortunately, I don't think I of deep enough pockets, Paul, but thank you for the offer. And maybe just one more quick one for me. I was hoping you can just give an update on any plans you might have to extinguish the $400 million or so trust, just given that the securities, as of the end of this year now fully disallowed from Tier 1 capital?

Michael Pizzi (CFO):

Yes, Steven, if we look at the securities, they remain reasonably attractive from a debt spread perspective in terms of issuance, so we view them as really just liabilities at this point. To the extent that because they are somewhat a liquid, we see secondary trading in them or someone looking to move them, we will, from time to time, participate there, as they can be purchased at a discount but we have no intent to exercise the regulatory call.

Paul Idzik (CEO):

Steven, that's an order of magnitude less than the loan so we'll also take a call for you on the trust

Steven Chubak (Analyst - Nomura Securities Co, Ltd):

Sorry, Paul. I'll have to take a pass for a moment but I appreciate the offer and thanks for taking my questions.

Operator:

Dan Fannon with Jefferies.

Dan Fannon (Analyst - Jefferies LLC):

Thanks. Paul, I appreciate the additional color around the M&A strategy in the outlook. I guess, if you could give some additional commentary maybe around just the current environment, where there was some activity in the market and the industry this quarter. I guess how would you characterize the opportunity set in terms of pricing or the actual available properties today?

Paul Idzik (CEO):

Well, you guys are as aware as -- probably more aware than almost anyone else regarding what type things might fit into each of those categories. But I'll take this opportunity to say that neither Michael nor I nor our Board is going to have us overpay for any property. And I think that's about all we need to say.

Dan Fannon (Analyst - Jefferies LLC):

Okay. And I guess, Mike, a question on NIM. The guidance going to next quarter without you -- margin balances are down but I think in a previous answer to a question, you highlighted the rates are up, so just curious as to the outlook and the decline, I guess, roughly 15 or so basis points quarter over quarter and the drivers of that?

Michael Pizzi (CFO):

We're anticipating some normalization in the overall security speeds from the very low level that they were in the first quarter of the year. That's going to be the primary driver of the decline in securities yields that we're expecting to get to the guidance range for next quarter and for the full year.

Dan Fannon (Analyst - Jefferies LLC):

Got it. Thank you.

Operator:

Devin Ryan with JMP Securities.

Devin Ryan (Analyst - JMP Securities):

Thanks. Good afternoon. Congratulations on the nice quarter. Maybe just a follow-up here on just DOL considerations. Definitely appreciate that you guys don't anticipate big implications around the ability to provide services for clients, but I'm just trying to think in the near term, are there any consideration that you guys are thinking about?

I'm not sure if we see a slow down in roll over activity, just for some period as the final rule is being digested or maybe -- or even on the positive side, some evidence that, that more money is moving towards self-directed just as it's falling through the cracks at the brokerage firms on the retail side. I'm just curious if there's any other considerations we're not talking about?

Paul Idzik (CEO):

I think there's a whole host of, irrespective of what firm you are, there's a host of internal operational factors that all of us across the industry are going to have to deal with, even if it's just how you script telephone conversations regarding IRAs. So there's definitely work to be done and I'm convinced our team is going to be able to do that.

I think that this is just another indication that the model, that ETRADE's model within the self-directed industry is going to hold up pretty well and has the right secular trends supporting its continued growth. We see continued movement to digital, continued movement to self-directed. We think those things would show up well for what we're trying to do.

Devin Ryan (Analyst - JMP Securities):

Okay, got it. That's helpful and then I was just following up here on M&A thoughts. Another hypothetical but just curious how you guys would think about the utilization of stock in a deal, obviously, with pullback here a little bit in recent months. But if you're thinking about anything on the brokerage or bank side, how would you think about that or just the things that we're talking about or even thinking about, just not of the size stock would even be necessary?

Paul Idzik (CEO):

Devin, I -- it's just really hard to talk about theoreticals and I don't want to sound like former government officials but it's really difficult to just comment among theoreticals. So if we had anything to talk about, we will be really clear and explain our rationale, how we decided to fund it or anything but we -- it's just difficult to talk theoretically.

Devin Ryan (Analyst - JMP Securities):

Got it. Okay, no, that's fair enough and just last one. The NIM, just follow-up here again. On reinvestment rates, where are you guys seeing them right now in the securities portfolio as you're building out a little bit further and as some are rolling off? And within that outlook, what is implied in sec lending? Just curious where you see that with the lower margin balances?

Paul Idzik (CEO):

Reinvestment rate is about 175 to 200 basis point range. We've been pretty much in that range over the quarter. We're seeing a lot of volatility in rates but also seeing a lot of volatility in agency spread, so even on the days where rates move pretty low, we were still able to purchase at some attractive overall spread levels.

Within securities lending, securities lending did move down with margin although it's going to ebb and flow, both with the size of the margin book, as well as the amount of hard-to-borrows within the book, so even with the size of the book coming down, you can still see that we did fairly well overall in securities lending this quarter. And I think as the market more normalizes, we'll see the hard-to-borrow activity pick back up again.

Devin Ryan (Analyst - JMP Securities):

Got it. Great. That's helpful. Thank you.

Operator:

Christian Bolu with Credit Suisse.

Christian Bolu (Analyst - Credit Suisse):

Good evening, Paul. Good evening, Mike. So a question, I have a question unfortunately on M&A. I hear you loud and clear on the high bar to take on credit risk so just curious as to what kind of returns you would need to take on sec credit risk?

And then more broadly, what is the strategic rationale of even considering any current credit risk? I don't know. Do you believe you have some sort of competitive edge on evaluating credit or is there some other kind of strategic rationale that I am missing?

Paul Idzik (CEO):

Look, I think, Christian, I think we talked about some of this in the -- at some of the public comments we made at some of the conferences. Some of the areas we would look that have a wealth management and other areas within that fall within a banking space may come with some credit assets.

The return hurdle we're going to apply to any credit asset is going to be well in excess of our cost to capital in terms of putting the appropriate valuation on those businesses given they come with considerable risk. They are, therefore, tangential, really, in overall strategic fit to something that they come along with something that has a much broader strategic fit.

Christian Bolu (Analyst - Credit Suisse):

Okay, got it. And then pardon if I missed this one, but in prepared remarks but do you have an estimate for the impact of interest FDIC rates in the back half?

Paul Idzik (CEO):

If the REITs -- if the FDIC raises its threshold amount in Q3 which our sources lead us to believe they will, it's going to be about $1 million per quarter of increased assessment.

Christian Bolu (Analyst - Credit Suisse):

Okay, great. Thank you.

Operator:

Brian Bedell with Deutsche Bank.

Brian Bedell (Analyst - Deutsche Bank):

Thanks. Good evening, folks. Paul, maybe just talk a little bit more about the DOL and your IRA rollover business. Your retirement assets, I think are close to $50 billion. I guess, first of all, how much of that is in IRAs and then more strategically, with the DOL rules, how does that impact the Stock Plan Administration business and how -- in this strategy of converting those users over to your platform?

Paul Idzik (CEO):

We don't break out what portion of retirement assets are IRA versus other. With regard to Stock Plan business, it shouldn't impact our opportunities of continuing to make those participants great customers of ETRADE and in fact, may give us some opportunities to have some discussions along the way as they may not be getting as well served by some other providers as a result of this.

Brian Bedell (Analyst - Deutsche Bank):

Okay, so you view it as an opportunity essentially more than a -- something that could be burdensome?

Paul Idzik (CEO):

Well, it's definitely burdensome but I think it's an opportunity for our model relative to others.

Brian Bedell (Analyst - Deutsche Bank):

Okay, okay, great and then just in longer-term plan of accelerating organic growth, can you talk a little bit about, from the acquisition side, from a -- I guess from a capability perspective, what do you think you need to accelerate that client organic growth? What types of -- is it largely wealth management or do you feel you need more technology and like a robo-advisor capability?

Paul Idzik (CEO):

Well, we already do have a robo-advisory capability. We've had it for some time. We have our new version coming out later this year and something I look forward to talking more about on a subsequent call. But I would say there are several fronts for us on this accelerating organic growth.

One is you will have seen us do some significant hurrying over the last year and that's primarily across hiring more financial consultants. It also has to do with adding along with account growth, additional customer service people so that we're providing good service, and adding some professionals into the corporate services participant experience area where some of our nation efforts there are actually turning out very nicely.

The second is, we interact with every one of our customers digitally and you're seeing us do things to continue to improve our engine/mobile and to make our overall web experience and mobile experience the type of experience that makes people want to engage more fulsomely with us and with improving their financial health. So it's a bit of doing a lot of little things better and continuing down the path.

Brian Bedell (Analyst - Deutsche Bank):

And just lastly, on the -- how do you feel your transactional banking capabilities are now and again, I guess, is that something that looks attractive from an acquisition perspective, again, to cross-sell to your customers and accelerate their organic growth?

Paul Idzik (CEO):

Well, one of the things we are, as we said in the prepared comments, looking at is more along, as you think about the excitement that's taking place in the payment space across some of the fintech areas, are the type of things that we are starting to look at analytically with regard to, is that something we should build or is that something that I want to consider acquiring. But there are definitely ways we can improve some of the capabilities of our banking and banking like activities.

Brian Bedell (Analyst - Deutsche Bank):

Okay. Great. That's helpful.

Paul Idzik (CEO):

Specifically, in the payments area. Specifically in the payments area.

Brian Bedell (Analyst - Deutsche Bank):

Thank you very much.

Paul Idzik (CEO):

Thank you.

Operator:

Michael Carrier, Bank of America /Merrill Lynch.

Michael Carrier (Analyst - BoA Merrill Lynch):

Hi. Thanks guys. Mike, just a quick one. Just on the commission rate, you -- I think you mentioned that the activity in the corporate area was a bit lighter in the first quarter. Have you seen some of that improve with stability in the markets and would you expect some improvement going into 2Q, which is maybe less seasonal than what's typical?

Paul Idzik (CEO):

Well, I can tell you over the course of the quarter, we saw less initial activity in the early months and it did pick up a little bit in the later months but not meaningful enough to have an effect on the commission per trade, being down $0.02 from Q4.

But if you look back to last year, you will see that typically, there's a pretty powerful effect on commission per trade that we didn't see directly come through this quarter. Whether we see some of that come through this quarter or not, I think we're going to have to wait and see how things progress.

Michael Carrier (Analyst - BoA Merrill Lynch):

Okay, thanks. And then Paul, just one quick one on the M&A or the growth side. I think on one hand, when you look at getting through or growing through the $50 billion, you mentioned in a different rate environment and maybe if the cash generation was stronger than you would potentially pursue that. Just wanted to get your sense on what environment that might be.

And then on the strategic side, it seems like there's a ton going on in financials and the tech area, or fintech. On one hand, it seems like that's the pricier area but on the other hand, it's obviously where the industry is going. So I just wanted to get your thoughts on how quickly can you build something versus having to acquire something and vice versa.

Is there a lot of demand out there for a financial services company for -- on the tech side, meaning tech firms looking at financial service firms to grow in that space?

Paul Idzik (CEO):

Let me try and take those in turn. I would say the jumping over the $50 billion mark is impacted by two things. Clearly, you want to have a quantum of cash that makes it worth your while to earn on that cash. Because the costs are the same, whether you're at $51 billion or $61 billion.

And the rate environment, obviously, makes it easier to jump more quickly; just do the math. With regard to looking at fintech opportunities, I think the question for us continues to be, how quickly can we deploy something across our customer base and would it bring incremental revenues? Would it strengthen the customer tie with our Company and so we're continuing to look.

I do think the valuations make certain deals difficult and so we evaluate that but speed to market is important and I'm not all that familiar, I presume some of your guys would be more familiar than I am with a lot of fintech firms looking at actually acquiring something that's going to get them nicely regulated to the degree that I don't think they can even possibly imagine. So that would be my way of looking at it.

Michael Carrier (Analyst - BoA Merrill Lynch):

Yes, all right. Thanks a lot.

Operator:

There are no further questions at this time. I will now turn the call back over to you.

Paul Idzik (CEO):

Well, thank you, Ash. Again, I want to thank everyone for joining us for this quarter. I'm particularly proud of the team this quarter and look forward to talking to you in a few months. Thank you. Good-bye.

Operator:

Ladies and gentlemen, that does conclude the call for today.