E-Trade: The Online Investing Powerhouse

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ABSTRACT

This case study addresses the online investment powerhouse, E-Trade. E-Trade is a mainstay of online trading. E-Trade was among the earliest online trading platforms and has proven to be one of the most successful. The company has grown from a mere online trading platform to a platform with a full array of financial services, to include depository banking. E-Trade has seen its share of trials and tribulations from the Dot-Com Bubble bursting, to 9-11, and then through the Great Financial Crisis of 2008. E-Trade successfully navigated the chaos and hardships, learned from its mistakes, and prospered.

Keywords: finance, investments, bank, international, SEC, brokerage, crisis, merger, acquisition, ethics

CASE OBJECTIVES

The purpose of this case study is to evaluate an early online trading platform through the Dot-Com Bubble bursting in March 2000, on through the terrorist attacks on September 11, 2001, and then through the Great Financial Crisis of 2008. Students should consider the many problems that all businesses, and particularly fledgling businesses, especially in the financial sector, were faced with in that era of financial instability. Consider the newness of the Internet in that era and the infantile nature of contemporary online businesses. Students should then discuss the implications of many evolutions of online financial businesses and security trading, along with the associated ethical dilemmas created by or associated with these events. Particular attention should be given to the impacts on the financial markets in general, hence the financial systems and economies of the US and the world at large.

INTRODUCTION

Very few individuals who are knowledgeable in finance, economics, and investments will be unaware of E-Trade Financial Corporation (E*TRADE). Many have active accounts with E-Trade, as it is one of the largest brokerage services on the planet. The 2020 Morgan Stanley press release announcing its acquisition of E-Trade notes that the company has “over 5.2 million client accounts with over $360 billion of retail client assets.” However, even people who are aware of the company or use its services may not know a lot about how the company began, how ever-changing financial and economic circumstances throughout its history transformed the company into what it is today, and what lessons can be learned from its history. In an attempt to provide new perspectives on traditional financial-economic theory and possibly help guide other institutions that find themselves in similar situations in the future, this paper examines E-Trade as a company, the challenges it has faced, and how it overcame these challenges,

According to its MarketLine Company Profile, E-Trade is an online brokerage firm that provides digital investment and information services primarily to individual investors, as well as face-to-face services and online consults at various E-Trade centers in the United States (E*TRADE Financial Corp., 2023). Through these services, E-Trade strives to equip its customers with the necessary information to make independent investment decisions (E*TRADE, 2017). The discussion in this paper seeks to illustrate what E-Trade aims to accomplish as a company, but in order to give the ensuing discussions proper context, this paper first examines the specific products and services E-Trade provides to its customers.

PRODUCTS AND SERVICES

The company’s products are divided into five categories as follows:

- Trading
- Investment
- Banking and Cash Management Capabilities
- Corporate Services
- Advisor Services

According to MarketLine, E-Trade provides digital trading products and services to the independent traders who make up most of its consumer base through digital mediums like mobile phones and desktop computers. E-Trade's Trading category covers a wide array of securities such as stocks, options, bonds, Exchange Traded Funds (ETFs), and more. E-Trade also offers American depository receipts (ADRs). The company does not seem to offer direct investment in foreign exchanges at this time, although it did earlier in its history. The trading order system is fully automated, and margin accounts are available to qualified customers. Informational services such as screening tools, educational content, and other research tools are also offered.

In the Investment category, E-Trade offers managed long-term portfolios with a variety of investment goals, including, but not limited to, core and fixed income portfolios. Like many discount brokers today, E-Trade also offers its customers many different mutual funds and ETFs. Similar to the Trading product category, there are also informational services including educational content and useful tools geared more toward long-term investment. Professional guidance is also offered within this category through E-Trade financial centers throughout the country.

E-Trade offers various products and services within its Banking and Cash Management Capabilities category. First, it offers FDIC-insured deposit accounts which also serve as brokerage accounts. Many other products in this category improve the "quality-of-life" for E-Trade's banking customers. Among these are ATM fee refunds on E-Trade debit cards, mobile check deposits, and digital bill payment services. Customers are also offered Premium Savings Accounts, which function essentially as normal savings accounts but with higher yields for the customer. E-Trade Line of Credit is another unique banking service which allows customers to use their assets held with E-Trade as collateral to borrow additional funds against. In its Corporate Services category, E-Trade mainly assists other companies in managing plans for their employees. E-Trade employs its Equity Edge Online platform to automate this process. Available plans include stock purchase plans, stock option plans, and restricted stock plans. E-Trade also offers complementary services like simplified tax calculations and international disbursal to help companies manage these plans.

E-Trade's Corporate Services provide companies with various educational tools. E-Trade helps companies involved in public trading navigate the process of filing with the SEC and implementing 10b5-1 plans.

In its Advisor Services product category, E-Trade serves registered investment advisors (RIAs) using its Liberty platform. E-Trade assists RIAs through Liberty with a number of custody service features, including rebalancing, reporting, and practice management tools. We can see the interconnected nature of these product branches in the E-Trade Advisor Network. This is a program that E-Trade uses to invite RIAs who use the Liberty platform to open an account for personal trading, investing, or banking.

These five categories (Trading, Investment, Banking and Cash Management, Corporate Services, and Advisor Services) make up the products and services E-Trade offers.

MarketLine notes that in their international operations, E-Trade owns locations or subsidiaries in The Netherlands, The Philippines, the United Kingdom, Canada, Hong Kong, and the Cayman Islands (E*TRADE Financial Corp., 2023). However, E-Trade's website does not currently allow individuals residing outside the United States to open an account.

HISTORY, MERGERS AND ACQUISITIONS, EXTERNAL FACTORS

This section addresses E-Trade's history, including mergers and acquisitions, along with any changes in government regulations, Federal Reserve policy, and other economic environmental changes and the impact these things may have had on E-Trade as it grew. The advantage of studying the firm's history, its mergers and acquisitions, and its external environment is that it demonstrates how E-Trade got to where it is today. Specifically, this provides insight into what types of strategies E-Trade has pursued throughout its life cycle. This section also looks at which of these strategies worked and which did not, as well as what economic environmental changes may have affected either the formulation of the firm's strategies or the implementation of them. After reviewing these things in a historical context, this section dives deeper into why these things may have occurred in the way that they did.

Because it was a private company for essentially its first fourteen years of existence, any early historical record on E-Trade is incredibly sparse; nonetheless, some early information was available. The "About us" page on E-Trade's official website[1] states that E-Trade was founded in the early 1980s. This can be supplemented using E-Trade's July 2020 Investor Presentation, which states that E-Trade was founded in Palo Alto, California in 1982 by Bill Porter, and that the first successful online trade using E-Trade was completed in 1983 (E*TRADE, 2020). When founded E-Trade was originally known as TradePlus but was later renamed prior to its IPO. The company grew throughout the early- and mid-1980s, establishing relationships with such brokerage firms as C.D. Anderson, Fidelity, and Quick & Reilly, but growth slowed with the 1987 market crash. E-Trade recovered along with the market through the first few years of the 1990s (E*TRADE Financial Corporation History).

E-Trade went public in August of 1996[2] during a pronounced and very strong bull market. In this favorable environment, the increasingly widespread use of the Internet and its rapidly expanding capabilities spurred massive interest and participation. This participation extended into the financial markets and specifically into online trading. E-Trade benefitted handsomely from this boom throughout the late 1990s, and by 1998 its trading systems were processing around 12-percent of all online trades, only lagging behind Charles Schwab and Waterhouse (Wu, Siegel, and Manion, 1999). During this "high" period, E-Trade began acquiring other businesses, starting with Hambrecht & Quist's OptionsLink division along with the privately held firm, ShareData.[3] These two businesses provided stock option services as well as stock plan management services. These acquisitions laid the foundation for E-Trade's Corporate Services division and marked the beginning of E-Trade's pursuit of diversification. E-Trade followed these acquisitions in 1999 with purchases of the Irish financial services firm TIR Holdings as well as ClearStation (E*TRADE, 2005), which was essentially an online investing community providing various services. While E-Trade was initially founded to process online trades, it was around this time that the company's focus began shifting toward becoming a complete provider of financial services.

The favorable business environment of the late 1990s was crucial to E-Trade's emergence as a top discount brokerage firm in the United States, and growth continued right up to the turn of the century and the bursting of the Dot-Com Bubble. The Dot-Com Bubble was caused in part by widespread and often irrational speculation in many fast-growing online companies, like E-Trade, and the fallout for these companies was harsh. Leading up to the bursting of the bubble in 2000, E-Trade aggressively expanded its operations. In January 2000 E-Trade purchased the online-banking platform Telebank and rebranded it as E-Trade's Banking

[1] https://about.etrade.com/home
[2] https://www.cnet.com/tech/mobile/etrade-hits-wall-street/
[3] https://www.cnet.com/tech/tech-industry/etrade-to-acquire-sharedata/

division the following April. In addition to acquiring Telebank, E-Trade also purchased Card Capture Services (CCS) in 2000, which was rebranded as E-Trade Access and gave the company a network of 9,600 ATMs (E*TRADE, 2001). It is important to note that E-Trade's move into banking services closely coincided with the passing of the Gramm-Leach-Bliley Act (GLBA) of 1999.[4] The GLBA's most notable provision was the repeal of the Banking Act of 1933, more commonly known as the Glass-Steagall Act, which disallowed depository financial institutions (depository banks) from dealing in securities trading and providing banking services simultaneously (Maues, 2013). The GLBA allowed financial institutions to better diversify their services, and E-Trade immediately took advantage of this. While the Riegle-Neal Interstate Banking and Branching Efficiency Act is also relevant here, because that Act was passed in 1994 (Medley) prior to E-Trade going public, it is unlikely that any of the Acts it repealed restrained E-Trade's expansion into the banking arena.

In the years following the Dot-Com Bubble burst, E-Trade continued to "[move] forward aggressively into new lines of business," (E*TRADE, 2002) by acquiring mortgage origination firm LoansDirect and market maker Dempsey & Company. After expanding into the mortgage industry with the LoansDirect acquisition, E-Trade also purchased Ganis Credit Corporation in 2002,[5] which would become E-Trade Consumer Finance. E-Trade also bolstered its core brokerage services in 2002, purchasing trading platforms and assets from Tradescape and A.B. Watley.[6] After 2002, E-Trade made no acquisitions for a few years and also sold its ATM network to Cardtronics (E*TRADE, 2005). However, E-Trade continued to offer benefits to its customers when they used other ATMs (e.g., ATM usage fee rebates). In 2005, E-Trade grew its online trading services further with acquisitions of brokerage services HarrisDirect and BrownCo (E*TRADE, 2006). E-Trade continued to expand and diversify right up to the 2008 financial crisis, purchasing advisory firm Retirement Advisors of America in 2006 (E*TRADE, 2007). However, E-Trade's previous expansion into the mortgage industry would ultimately prove to be very costly for the company amidst the havoc of the 2008 crisis.

According to Reuters, E-Trade's losses from the bursting of the housing bubble and the ensuing financial crisis were significant as E-Trade had a proportionally larger loan portfolio relative to its industry (Spicer, 2008). In response, E-Trade stopped originating and buying loans as early as 2007 (E*TRADE, 2010) and began paying down its outstanding loan balances. In E-Trade's 2008 Corporate Report, then-CEO Donald Layton put strong emphasis on refocusing the company towards its core competencies: brokerage and investing services, along with a positive customer experience (E*TRADE, 2009). This shift in focus back to growing its core services carried E-Trade through these down years, and in 2011 the company became profitable for the first time since 2006 (E*TRADE, 2012). As the early 2010s progressed, E-Trade continued recovering from the 2008 crisis. In 2014, 146,000 new traders opened accounts with E-Trade, which was the best mark over the previous ten years, and this year also saw an all-time high in additional assets (E*TRADE, 2015). In 2016, E-Trade was stronger than ever, making its first major acquisition in ten years when it purchased top-rated options platform OptionsHouse (E*TRADE, 2017). From 2016 to Morgan Stanley's acquisition of E-Trade in 2020, the company experienced nothing but positive years. In 2018, E-Trade completed the acquisition of custody service provider Trust Company of America, or TCA, bolstering its Advisor Services

[4] Passed on November 12, 1999 per www.ftc.gov
[5] https://www.americanbanker.com/news/e-trade-bank-buying-ganis
[6] https://www.finextra.com/newsarticle/5347/etrade-acquires-tradescape-and-ab-watley-active-trading-technology

product category. The company consistently improved its brokerage services over this period as well, integrating the OptionsHouse platform as Power E*TRADE and introducing a mobile app (E*TRADE, 2019). E-Trade diversified further with its purchase of student loan platform Gradifi in 2019, which also strengthened its Corporate Services division (E*TRADE, 2020). By this time E-Trade had truly become one of the world's leading financial services platforms. The company had fully recovered from a disastrous 2008 and then some, and it may have been at its absolute strongest when it was acquired by Morgan Stanley in 2020.

ORGANIZATIONAL STRUCTURE

Since its inception, E-Trade Financial Corporation has maintained a holding company structure, operating a number of subsidiary companies. Just prior to the Morgan Stanley Merger, seventeen subsidiaries were active:

- E-Trade Bank
- E-Trade Capital Management, LLC—The E-Trade Capital Management, LLC subsidiary responsible for advisory services for investments.
- E-Trade Community Development Corporation
- E-Trade Financial Corporate Services, Inc.—The E-Trade Financial Corporate Services subsidiary responsible for equity planning.
- E-Trade Futures, LLC—The E-Trade Futures subsidiary responsible for brokerage of commodity futures and options on other futures type securities.
- E-Trade Information Services, LLC
- E-Trade Next, LLC
- E-Trade RV and Marine Trust 2004-1
- E-Trade Savings Bank
- E-Trade Securities, LLC—The E- Trade Securities subsidiary is responsible for execution of securities trades for clients.
- ET Canada Holdings, Inc.
- ETB Holdings, Inc.
- ETCF Asset Funding Corporation
- ETCM Holdings, LLC
- ETRADE Securities (Hong Kong) Limited
- Distribution Financial Services RV/Marine Trust 2001-1
- TIR (Holdings) Limited (Cayman)

E-Trade Bank and E-Trade Savings Bank both held Federal Charters and were responsible for offering banking products and services for E-Trade customers.[7]

STRUCTURAL CHANGES, CURRENT SITUATION, AND DISCUSSION

This section examines the environmental factors and the decisions that influenced E-Trade's evolution over the last twenty years or so. The focus of this discussion is on the twenty years leading up to E-Trade's acquisition by Morgan Stanley in 2020, along with a discussion of

[7] https://cdn2.etrade.net/1/20022415120.0/aempros/content/dam/etrade/about-us/en_US/documents/investor-relations/financials-sec-filings/quarterly-earnings/2019/Q4/2019-Q4-10K.pdf

the state of the company in the few years since the acquisition. A deeper look into the financial and economic environmental factors that underscored E-Trade's evolution provides insights into why things likely happened the way they did and what maybe could have been done differently. Additionally, selected E-Trade financial statements and a chart plotting E-Trade's income and losses from 2000 to 2019 are provided in the Appendix. These documents provide additional insight into the discussions that follow but aren't necessary to the discussions.

To understand how E-Trade has evolved, a good understanding of E-Trade's "starting point" and its identity as a company at the beginning of this period is necessary. Coming into 2000, E-Trade was already a major brokerage firm in the U.S., expanding at around 9% per month in 1999 (Wu, Siegel, and Manion, 1999). The explosion of innovation and technological advancements of the mid- to late-1990s were vital to E-Trade's early growth. However, E-Trade was not very diversified at this point, with a new corporate services division being the only part of E-Trade's offerings outside of its core brokerage services. As previously stated, E-Trade Bank launched E-Trade Access and the company's ATM network in early 2000. These developments were made not long after the Glass-Steagall Act was repealed in 1999. E-Trade's then-CEO Christos Cotsakos identified this environmental change as a promising opportunity and quickly acted on it to diversify E-Trade's portfolio of businesses, and this was a momentous point in E-Trade's evolution. E-Trade Bank was a resounding success, becoming the 19th largest U.S. federally chartered savings bank in just one year (E*TRADE, 2001). E-Trade's ATM system was sold to another company only a few years later, and this is discussed in deeper detail shortly. E-Trade still provides banking services today, and this is thanks to the repeal of the Glass-Steagall Act in concert with the vision of Christos Cotsakos and E-Trade's senior leadership.

The bursting of the Dot-Com Bubble in 2000 severely slowed E-Trade's growth. In 2001, revenues were down nearly 7%, a small profit gained in 2000 gave way to huge net losses in subsequent years. This was mostly due to E-Trade's daily brokerage transactions being down over 30% in this period (E*TRADE, 2002). During these down years, it was later discovered that CEO Christos Cotsakos had been awarded a lucrative compensation package in 2002, worth close to $80 million. This was unbelievably high pay for his position by any measure, and negative publicity surrounding this controversy may have played a part in Cotsakos's eventual resignation in 2003, although Cotsakos as well as his replacement, Mitchell Caplan, deny this.[8] This was the first major public controversy that surrounded E-Trade, and although he ended up giving a portion of this package back, it is interesting to consider why Cotsakos would negotiate for such unreasonable compensation in the first place and why E-Trade's board would approve it. Perhaps it was seen as an appropriate reward for E-Trade's incredible success in its first few years as a public company, but with the company experiencing a series of poor years following 2001, this was generally seen as inappropriate. This was a major ethical dilemma and represented an awful decision that cast very unfavorable public light on E-Trade.

In 2004, E-Trade sold its ATM network to Cardtronics (E*TRADE, 2005), a change that has remained to this day. This seems to be an odd decision at first glance. After all, E-Trade had purchased the ATMs only four years prior. President of E-Trade's banking division Arlen Gelbard claimed in a statement that this was in the company's best interest and legislation regarding check clearing was a driving factor behind this decision,[9] which was directly counter

[8] https://www.sfgate.com/business/article/Cotsakos-quits-E-Trade-CEO-s-sudden-exit-comes-2677288.php
[9] https://www.digitaltransactions.net/etrade-sells-its-atm-network-to-cardtronics-for-106-million/

to some other perspectives on this decision. One 2004 headline[10] covering this story reads "Poor Fit? Low Returns? E-Trade to Sell Its ATMs." However, it appears that Gelbard and others were correct and knew what they were doing. A few months before E-Trade made this deal with Cardtronics, a bill was introduced in the House of Representatives that was eventually passed as the Check Clearing for the 21st Century Act, or the Check 21 Act. In short, this Act loosened check clearing regulations to make a copy of a check legally equal to the original check (H.R.1474). This made it easier for banks to process checks electronically by proxy. E-Trade's strategy here begins to make sense when this is considered. That is, although E-Trade's original acquisition of the ATM network seemed completely reasonable at the time, it later became clear that its purchase was maybe a bit shortsighted as rapidly advancing technology as well as loosening regulations made such an in-house ATM system superfluous. E-Trade customers could now use other company's ATMs and have E-Trade process their checks electronically, so owning the ATM business wasn't really necessary. This was a major strategic pivot by E-Trade's leadership, and its positive effects on the company continue today., These were among the most major structural changes E-Trade experienced throughout the early 2000s, but E-Trade would face its greatest challenges a few years later with the financial crisis of 2008.

E-Trade experienced a challenging period throughout 2007 as the United States economy was heating up to eventually boil over in 2008. The company was faced with abundant public drama and speculation regarding its ownership and operations in the aftermath of the financial crisis and recession. Net revenue for E-Trade turned negative from the end of 2006 to the end of 2007,[11] with a reported net loss of $1,441,754,000 for the year 2007. The area of greatest losses was in loans and securities. The largest contributor to these losses was the loss on asset-backed securities that were sold to hedge fund Citadel LLC that year. E-Trade had accumulated the vast majority of these securities by originating them in house. Upon the 2000 merger with Telebank, E-Trade began to offer mortgage loans to its banking and savings customers (Kulikowski, 2009).

An additional piece of the Citadel and E-Trade deal was the issuance of $1,750,000,000 of notes payable, at 12.5% interest, and stock to Citadel. With this, Citadel gained a controlling interest in E-Trade, heavily influencing decisions made during the financial crisis as will be discussed later (Zuill, 2007). Surrounding the high-profile sale to Citadel, was the resignation of then Chief Executive Officer Mitch Caplan. Caplan had been with E-Trade since 2003. E-Trade executives appeared to not be aware of the impending disaster in the financial markets that would come in 2007 according to Caplan's replacement Donald Layton. In the corporate report released for the year he expresses that the markets had an appearance of healthy well-being and continuing to track upwards as seen in preceding years.[12] The Citadel deal spelled nightmares for stockholders of E-Trade. Earnings Per Share were negative at $3.40 for the year. Loan holdings at the end of 2007 totaled $30,139,382,000.[13]

The year 2008 was not quite the bottom of the trough for E-Trade's financial woes. E-Trade experienced a net loss of $511,790,000 at year's end 2008. This was a 64.5% reduction in E-Trade's net loss; however, as operating interest expense was reduced by $758,722,000. A loss on loans and securities of $100,473,000 was also experienced this year. Also, during this year E-Trade eliminated its loan origination practices (Kulikowski, 2009). Loan holdings were reduced

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[10] https://www.americanbanker.com/news/poor-fit-low-returns-e-trade-to-sell-its-atms

[11] https://cdn2.etrade.net/1/19032518580.0/aempros/content/dam/etrade/about-us/en_US/documents/investor-relations/financials-sec-filings/quarterly-earnings/2007/Q4/10-K/2007-Q4-10K.pdf

[12] Ibid., 22

[13] Ibid., 22

by $5,687,530,000 from the previous year and totaled $24,451,852,000. This represented an 18.87% reduction in holdings. Earnings Per Share were improved to a negative $1 at the year's end.[14]

E-Trade reached its second lowest point during the year 2009. The company reported net losses of $1,297,762 at the year end. The was a situation where E-Trade's financials necessarily had to become worse temporarily before becoming better due to necessary fundamental changes in the company's financial structure, with the resulting negative impacts on reported annual finances. E-Trade's largest expense losses came from early major reductions in its debt over the year. This reduction in debt was a part of an effort to inject the company with capital through the process of exchanging debt for common stock of the company. A decision was also made to begin offering mortgage loans to deposit customers through third party institutions. In doing this, E-Trade mitigated possessory risk that would otherwise be associated with securities accounting on their balance sheet, had E-Trade originated the loans. Loan holdings for 2009 were reduced by 21.58% for the year. Earnings Per Share tanked to negative $11.85 for 2009, which was a direct function of diluting shares through common stock shares conversion.[15]

At the end of 2010, E-Trade began to further limit its losses. Reported net losses amounted to $28,472,000. Loan holdings were reduced by 21.10% for the year and Earnings Per Share subsequently improved to a negative $0.13 for the year.[16]

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 would have significant effects on the risk management structure of E-Trade. The Dodd-Frank Act encompasses many industry changes in the form of creation of new agencies. The Consumer Financial Protection Bureau was established to assist consumers in attaining financial literacy and transparency pertaining to mortgage products being offered to them. Prior to the establishment of this agency, lenders used various tactics that misled consumers to enter into debt obligations that they may have not fully understood. This bureau also discourages lenders from predatory loan practices, such as closing loans that charge effectively higher, but veiled interest rates through fees. In many cases this was the product of loan originators pursuing higher commissions and loan sales prices. The Consumer Financial Protection Bureau also has oversight over lending through credit cards (Hayes 2023).

The Office of Credit Ratings was also established under the Securities and Exchange Commission as a result of Dodd- Frank. This agency extension bears the responsibility of ensuring that accurate credit ratings of securities be provided by ratings agencies. The financial crisis showed that credit rating agencies had long been in the back pockets of the very institutions that they provided ratings for (Hayes 2023). This represented a significant unethical, if not criminal, conflict of interest.

The Financial Stability Oversight Council and The Orderly Liquidation Authority were also established under Dodd-Frank. The goal of the Financial Stability Oversight Council was to analyze and provide oversight of the financial reporting's of large firms operating in the financial industry. The Orderly Liquidation Authority's purpose was to provide assistance in the liquidation of failed firms. An extension of the Orderly Liquidation Authority is the Orderly

[14] https://cdn2.etrade.net/1/19032518580.0/aempros/content/dam/etrade/about-us/en_US/documents/investor-relations/financials-sec-filings/quarterly-earnings/2009/Q4/10-K/2009-Q4-10K.pdf
[15] Ibid., 25
[16] https://cdn2.etrade.net/1/19032518580.0/aempros/content/dam/etrade/about-us/en_US/documents/investor-relations/financials-sec-filings/quarterly-earnings/2011/Q4/10-K/2011-Q4-10K.pdf

Liquidation Fund. The Fund was established so that funds not generated by tax dollars would be available for use in liquidation of firms (Hayes 2023).

The last element of the Dodd-Frank Act that was implemented upon the financial industry was the Volcker Rule. The Volcker Rule places restrictions on the investing and trading practices of firms. The Rule primarily targets high-risk speculative and proprietary trading. The rule limits the ability of firms to conduct business with risk prone hedge funds and private equity firms (Hayes, 2023).

To comply with the Dodd-Frank Act of 2010, E-Trade invested significant effort into evaluating their risk exposure. Current Chief Executive Officer Michael Pizzi stated, "For us, no bigger investment came about from passage of the Dodd-Frank Act than stress-testing" (Jaeger, 2019). Stress-testing involves simulation of theoretical future financial situations. Stress-test reporting is mandated for institutions holding assets of greater than $50 billion (Kenton, 2022). This mandate falls under Comprehensive Capital Analysis and Review, also a byproduct of Dodd-Frank. E-Trade doubled the number of their risk managers across all functionally relevant areas of the company. A transition into shifting holdings to government and agency-backed debt, with little default risk, was a key component of a renewed strategy for E-Trade's asset holdings (Jaeger, 2019).

E-Trade realized positive net income in 2011. This was the first reported profit since 2006. The company netted $156,701,000 and reduced loan holdings for 2011 by $2,795,123,000, for a total holding of $12,332,807,000. This represented an 18.48% reduction in holdings. Earnings Per Share increased to $0.59 for the year.[17] Although returning to a profitable position, Citadel LLC was still dissatisfied with the company's performance. Citadel manager Ken Griffin drafted a letter to E-Trade's board of directors outlining his dissatisfactions. Griffin's dissatisfaction was significant enough that he requested a special meeting of the shareholders to initiate the restructuring of the board of directors to install leadership that would better serve the shareholders (Comstock, 2011).

Despite the upturn in the previous year, in 2012 E-Trade once again entered the red with a loss of $112,583,000. Significant changes in the Enterprise Risk Management Structure were also implemented this year. Loan holdings for 2012 decreased by $2,234,984,000 and totaled $10,098,723,000. This represented an 18.11% reduction in holdings. Earnings Per Share were a negative $0.39 for the year.[18]

E-Trade would realize net income of $86,012,000 for 2013. Upon satisfactory rises in stock price Citadel manager Ken Griffin made the decision to liquidate the hedge fund's remaining holdings in E-Trade stock. The decision to sell Citadel's remaining holdings came after E-Trade reached a fifty-two-week high in March of 2013 (Fontevecchia, 2013). Loan holdings for 2013 would be reduced by $1,976,106,000, for a total of $8,122,617,000. This was a 19.57% reduction in loan holdings. Earnings Per Share improved to $0.30 for 2013.[19]

Through the crisis years, E-Trade's losses totaled $2,095,896,762. Loan holdings were slashed by 73.05% over the span of six years. Bolstered by the wit of Ken Griffin and Citadel throughout the crisis, E-Trade is an exemplary case where private equity prevailed over government bail-out. In a sense this echoes the traditional free-market edict of letting market

[17] Ibid., 27

[18] https://cdn2.etrade.net/1/19032712530.0/aempros/content/dam/etrade/about-us/en_US/documents/investor-relations/financials-sec-filings/quarterly-earnings/2013/Q4/10-K/2013-Q4-10K.pdf

[19] Ibid., 29

forces determine which companies are strong and which are not—the proverbial concept of the survival of the fittest.

E-Trade's strategic decisions and evolution were defined by the effects of the 2008 financial crisis throughout the late 2000s and in years to follow. In 2010, E-Trade made a secondary public offering of 172 million shares at $1.75 per share and introduced a mobile application for Android smartphones through its E-Trade Securities subsidiary (E*TRADE Financial Corp., 2023). The latter is a rather simple and logical innovation in a rapidly developing technological environment, but secondary public offerings often carry negative connotations to the public and are often seen as undesirable for a company's current stockholders, due to things such as equity dilution. However, with E-Trade still reeling from the 2008 fallout, the company was still in need of additional cash, so these risks were deemed to be acceptable. In 2010 interest rates were quite low due to the Fed's zero-bound monetary,[20] so this was a good time for the company to issue new stock with the price of raising funds at a low point. E-Trade continued to make improvements in its services throughout the 2010s, such as introducing an online informational service called Investing Insights in 2013 and launching a new application for iPhones with improved security and quality-of-life features in 2014 (E*TRADE Financial Corp., 2023). Many of these developments were focused on taking advantage of the ever-increasing efficiency in information consumption provided by advancing smartphone capabilities. In 2015, E-Trade made the decision to shut down its retail FOREX trading platform.[21] The FOREX platform had not been very profitable nor did this service fall within E-Trade's core business model, so this was a logical move. E-Trade's next major improvement came in 2016 when the company acquired a top options platform, OptionsHouse (E*TRADE, 2017). This enhanced E-Trade's ability to support options trading, an investment arena that would only grow in stature as information technology and trading continued to become more efficient.[22]

It appears that the COVID-19 pandemic and its market effects did not have any profound negative impacts on E-Trade, outside of general market effects. According to Bloomberg Law E-Trade's merger and acquisition agreement with Morgan Stanley, when the financial services company acquired E-Trade in February 2020, the deal excluded coronavirus as having a material adverse effect (MAE) on firm value. An MAE is essentially some negative event or change that affects a company's prospects, hence value, and, hence, allows the company to opt out of the deal. By willingly preventing themselves from potentially using COVID-19 as a reason to opt out of its acquisition, E-Trade signals that it had already considered these risks and evidently did not think them large enough to keep this option available. E-Trade and Morgan Stanley did still include coronavirus as having a disproportionate adverse effect, which is similar to an MAE but requires that the event or occurrence in question affect the company to an extreme degree (Burnett, Demblowski, and Holt, 2020). This demonstrates that E-Trade and Morgan Stanley alike were not too worried with the risks of COVID-19 overall. This also makes intuitive sense, as E-Trade conducts most of its operations online anyway.

[20] https://fred.stlouisfed.org/series/REAINTRATREARAT10Y
[21] https://www.forex.academy/why-did-e-trade-stop-trading-forex/
[22] https://www.chicagotribune.com/business/blue-sky/ct-etrade-optionshouse-acquisition-bsi-20160725-story.html

CONCLUSION

E-Trade's history may be best summarized as a firm's evolution from an online trading platform to a provider of a robust array of financial services. E-Trade made many different strategic decisions and acquisitions to in route to where they are today, with some working better than others. E-Trade's main struggle in these endeavors was to diversify its services without spreading itself too thin and straying away from its core competencies. For example, compare E-Trade's branching into things like ATM systems and loan origination with acquisitions of OptionsHouse and Telebank. The ATM system was a bit superfluous, and the loan origination service was downright disastrous during the financial crises, but OptionsHouse was a natural addition to E-Trade's core brokerage service while acquiring Telebank (which became E*TRADE Bank) is arguably E-Trade's greatest decision to date.

Since being acquired by Morgan Stanley in 2020, E-Trade has remained a premier provider of financial services in the United States, and there are a few different ways the company can go from here. Three major options arise for E-Trade's further growth moving forward:

1. Continue to focus primarily on improving the firm's core brokerage services. This would include acquisitions that bolster E-Trade's brokerage systems, such as that of OptionsHouse, and/or expand the number of investment vehicles provided. For example, E-Trade may choose to introduce options for direct investment in cryptocurrencies or even a potential return to retail FOREX trading. This option would also include further development of the technologies that support E-Trade's trading platforms to make these systems as efficient as possible. This is likely E-Trade's least risky option as the company would be sticking to what works, but this option also probably leads to lower overall growth potential.
2. Focus more on the improvement of E-Trade's peripheral financial services such as E*TRADE Bank and E*TRADE Corporate Services. This approach would not completely neglect E-Trade's core services and would also better acknowledge E-Trade's status and responsibilities as a major financial institution. This option likely holds more growth potential than option 1, but it also introduces more risk in the event that one of E-Trade's investments in its secondary services fails.
3. Strive to develop E-Trade's core brokerage services and more successful secondary services in roughly equal parts. Like option 2, this approach may put some small limit on E-Trade's growth, but maintaining an adequate focus on the firm's core competencies also helps reduce risk. This approach does not fully commit all the firm's resources to developing any single product category, but it also best acknowledges that while E-Trade's brokerage services are its core competency, some of its other services have been quite successful and can potentially be great strengths moving forward.

DISCUSSION

E-Trade is a well-known Internet-based trading platform for trading financial assets. It has grown into one of the largest trading platforms available. It has had more than its share of hard times and very successful times, and the general market consensus is that it will be around for years to come. That said, there has been a lot of perturbations in the financial markets over the past several decades due to continual wars around the world, uncontrolled government spending, changing and radicalization of national politics, and civil unrest; hence, the future appears volatile. How might this affect E-Trade?

Note the recommendations discussed in the Conclusion section of this case study. If you were to choose among them, how would you rank order them. Which of these would be the best? Or would a combination of them be best? What other actions might be advisable to maintain E-Trade as a viable and useful service to the public?

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APPENDIX

Table 1. This table presents E-Trade's consolidated statements of income for 2017, 2018, and 2019. Source: E-Trade

E*TRADE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(In millions, except share data and per share amounts)

	Year Ended December 31, 2019	2018	2017
Revenue:			
Interest income	$ 2,111	$ 2,009	$ 1,571
Interest expense	(259)	(163)	(86)
Net interest income	1,852	1,846	1,485
Commissions	421	498	441
Fees and service charges	588	431	369
Gains (losses) on securities and other, net	(23)	53	28
Other revenue	48	45	43
Total non-interest income	1,034	1,027	881
Total net revenue	2,886	2,873	2,366
Provision (benefit) for loan losses	(51)	(86)	(168)
Non-interest expense:			
Compensation and benefits	670	621	546
Advertising and market development	196	200	166
Clearing and servicing	133	126	124
Professional services	105	96	99
Occupancy and equipment	135	124	116
Communications	99	116	121
Depreciation and amortization	88	92	82
FDIC insurance premiums	14	30	31
Amortization of other intangibles	61	48	36
Restructuring and acquisition-related activities	23	7	15
Losses on early extinguishment of debt	—	4	58
Other non-interest expenses	94	77	76
Total non-interest expense	1,618	1,541	1,470
Income before income tax expense	1,319	1,418	1,064
Income tax expense	364	366	450
Net income	$ 955	$ 1,052	$ 614
Preferred stock dividends	40	36	25
Net income available to common shareholders	$ 915	$ 1,016	$ 589
Basic earnings per common share	$ 3.86	$ 3.90	$ 2.16
Diluted earnings per common share	$ 3.85	$ 3.88	$ 2.15
Weighted average common shares outstanding:			
Basic (in thousands)	237,396	260,600	273,190
Diluted (in thousands)	237,931	261,669	274,352

Table 2. This table presents E-Trade's consolidated balance sheets for 2018 and 2019. Source: E-Trade

E*TRADE FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(In millions, except share data)

	December 31, 2019	December 31, 2018
ASSETS		
Cash and equivalents	$ 750	$ 2,333
Cash segregated under federal or other regulations	1,879	1,011
Available-for-sale securities	19,501	23,153
Held-to-maturity securities (fair value of $22,246 and $21,491 at December 31, 2019 and 2018, respectively)	21,969	21,884
Margin receivables	9,675	9,560
Loans receivable, net (net of allowance for loan losses of $17 and $37 at December 31, 2019 and 2018, respectively)	1,595	2,103
Receivables from brokers, dealers and clearing organizations	1,395	760
Property and equipment, net	339	281
Goodwill	2,510	2,485
Other intangibles, net	433	491
Other assets	1,370	942
Total assets	$ 61,416	$ 65,003
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits	$ 38,606	$ 45,313
Customer payables	12,849	10,117
Payables to brokers, dealers and clearing organizations	893	948
Corporate debt	1,410	1,409
Other liabilities	1,115	654
Total liabilities	54,873	58,441
Commitments and contingencies (see Note 20)		
Shareholders' equity:		
Preferred stock, $0.01 par value, 1,000,000 shares authorized, 403,000 shares issued and outstanding at both December 31, 2019 and 2018, respectively; aggregate liquidation preference of $700 at both December 31, 2019 and 2018, respectively	689	689
Common stock, $0.01 par value, 400,000,000 shares authorized, 222,622,333 and 246,495,174 shares issued and outstanding at December 31, 2019 and 2018, respectively	2	2
Additional paid-in-capital	4,416	5,462
Retained earnings	1,464	684
Accumulated other comprehensive loss	(28)	(275)
Total shareholders' equity	6,543	6,562
Total liabilities and shareholders' equity	$ 61,416	$ 65,003

Table 3. This table presents E-Trade's consolidated statements of cash flow for 2017, 2018, and 2019. Source: E-Trade

E*TRADE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Year Ended December 31,		
	2019	2018	2017
Cash flows from operating activities:			
Net income	$ 955	$ 1,052	$ 614
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision (benefit) for loan losses	(51)	(86)	(168)
Depreciation and amortization (including amortization and accretion on investment securities)	225	244	262
(Gains) losses on securities and other, net	23	(53)	(28)
Losses on early extinguishment of debt	—	4	58
Share-based compensation	53	46	41
Deferred tax expense	245	339	450
Other	15	18	(7)
Net effect of changes in assets and liabilities:			
(Increase) decrease in receivables from brokers, dealers and clearing organizations	(635)	418	(134)
Increase in margin receivables	(115)	(489)	(2,340)
(Increase) decrease in other assets	(204)	159	(49)
(Decrease) increase in payables to brokers, dealers and clearing organizations	(55)	(594)	559
Increase in customer payables	2,732	668	1,290
(Decrease) increase in other liabilities	(341)	(40)	34
Net cash provided by operating activities	2,847	1,686	582
Cash flows from investing activities:			
Purchases of available-for-sale securities	(8,382)	(8,386)	(9,819)
Proceeds from sales of available-for-sale securities	10,735	7,423	1,645
Proceeds from maturities of and principal payments on available-for-sale securities	1,588	1,944	1,588
Purchases of held-to-maturity securities	(4,688)	(4,163)	(10,519)
Proceeds from maturities of and principal payments on held-to-maturity securities	5,307	2,395	2,556
Proceeds from sales of loans	80	30	40
Decrease in loans receivable	463	609	983
Capital expenditures for property and equipment	(149)	(112)	(102)
Net increase in securities purchased under agreements to resell	(200)	—	—
Proceeds from sale of real estate owned and repossessed assets	14	24	29
Acquisitions, net of cash acquired	(29)	(150)	—
Net cash flow from derivative contracts	(277)	221	66
Other	(34)	(25)	(43)
Net cash provided by (used in) investing activities	4,428	(190)	(13,576)

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

	Year Ended December 31, 2019	2018	2017
Cash flows from financing activities:			
(Decrease) increase in deposits	$ (6,707)	$ 1,781	$ 11,060
Common stock dividends	(135)	(36)	—
Preferred stock dividends	(40)	(36)	(25)
Net (decrease) increase in advances from FHLB	—	(500)	500
Proceeds from issuance of senior notes	—	420	999
Payments on senior notes	—	—	(1,049)
Payments on trust preferred securities	—	(413)	—
Proceeds from issuance of preferred stock	—	—	300
Repurchases of common stock	(1,085)	(1,139)	(362)
Other	(23)	(32)	(36)
Net cash (used in) provided by financing activities	(7,990)	45	11,387
(Decrease) increase in cash, cash equivalents and segregated cash	(715)	1,541	(1,607)
Cash, cash equivalents and segregated cash, beginning of period	3,344	1,803	3,410
Cash, cash equivalents and segregated cash, end of period	$ 2,629	$ 3,344	$ 1,803
Cash and equivalents, end of period	$ 750	$ 2,333	$ 931
Segregated cash, end of period	1,879	1,011	872
Cash, cash equivalents and segregated cash, end of period	$ 2,629	$ 3,344	$ 1,803
Supplemental disclosures:			
Cash paid for interest	$ 255	$ 157	$ 126
Cash paid for income taxes, net of refunds	$ 112	$ 11	$ 8
Right-of-use assets recognized upon adoption of new lease standard	$ 193	$ —	$ —
Right-of-use assets obtained during the period	$ 43	$ —	$ —
Non-cash investing and financing activities:			
Transfers of loans held-for-investment to loans held-for-sale	$ 78	$ —	$ 57
Transfers from loans to other real estate owned and repossessed assets	$ 17	$ 15	$ 27
Conversion of convertible debentures to common stock	$ —	$ —	$ 3
Transfer of available-for-sale securities to held-to-maturity securities	$ 744	$ 1,161	$ —
Transfer of held-to-maturity securities to available-for-sale securities	$ —	$ 4,672	$ —

Table 4. This table presents E-Trade's net income/loss from January 1, 2000, to January 1, 2019. Source: E-Trade