E*TRADE SECURITIES LLC

STATEMENT OF FINANCIAL CONDITION
AS OF JUNE 30, 2021
(UNAUDITED)

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STATEMENT OF FINANCIAL CONDITION
As of June 30, 2021
(In millions of dollars)
(Unaudited)

ASSETS		
Cash	$	320
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements		748
Securities purchased under agreements to resell		1,950
Securities borrowed		947
Receivables:		
Customers (net of $4 allowance for doubtful accounts)		16,795
Brokers, dealers and clearing organizations		370
Fees, interest and other		24
Affiliates		8
Goodwill		3,609
Intangible assets (net of accumulated amortization of $125)		2,709
Other assets		240
Total assets	$	27,720
LIABILITIES AND MEMBER'S EQUITY		
Securities loaned	$	2,886
Payables:		
Customers		15,880
Brokers, dealers and clearing organizations		106
Affiliates		42
Other liabilities and accrued expenses		980
Total liabilities		19,894
Contingent liabilities (See Note 9)		
Member's equity		7,826
Total liabilities and member's equity	$	27,720

See Notes to the Statement of Financial Condition.

1. Introduction and Basis of Presentation

The Company

E*TRADE Securities LLC (the "Company") provides brokerage services primarily to retail customers. The Company offers a comprehensive suite of financial products and services to individual investors, including automated trade order placement of U.S. equities, options, exchange-traded funds, non-proprietary mutual funds and bond orders. The Company also offers a margin lending program to qualifying customers, enabling them to borrow against their securities, and a fully paid lending program, which allows customers to earn income on certain securities held in cash accounts when the Company is permitted to lend their securities. The Company also offers products and services such as sweep deposits, cash management, extended hours trading, quotes, research and advanced planning tools. The Company's customers additionally have access to managed investment portfolios and futures trading capabilities through affiliate relationships. The Company carries security accounts for customers and clears the majority of its mutual fund transactions through an omnibus account arrangement with a third-party broker-dealer. See the “Glossary of Common Acronyms” for the definition of certain terms and acronyms used throughout the notes to the statement of financial condition.

The Company, a single member limited liability company (LLC), is a broker-dealer registered with the SEC and a member of FINRA, SIPC and various securities exchanges.

The Company is a wholly owned subsidiary of ETCM Holdings, LLC (ETCM Holdings), which is a direct wholly owned subsidiary of E*TRADE Financial Holdings, LLC (the "Parent"), an indirect wholly owned subsidiary of Morgan Stanley (the "Ultimate Parent").

Basis of Financial Information

The statement of financial condition is prepared in accordance with U.S. GAAP, which requires the Company to make estimates and assumptions regarding the valuation of goodwill and intangible assets, the outcome of legal and tax matters, deferred tax assets, and other matters that affect its statement of financial condition and related disclosures. The Company believes that the estimates utilized in the preparation of its statement of financial condition are prudent and reasonable. Actual results could differ materially from these estimates.

The Company has evaluated subsequent events for adjustment to or disclosure in the statement of financial condition through the date of this report and the Company has not identified any recordable or disclosable events, not otherwise reported in the statement of financial condition or the notes thereto, except for the below.

On July 1, 2021, the Company contributed its internally developed software, net asset of $210 to MSSG, an affiliated service entity, to better align with Morgan Stanley's service cost structure.

2. Significant Accounting Policies

Cash

Cash represents funds deposited with financial institutions.

Cash Deposited with Clearing Organizations or Segregated Under Federal and Other Regulations or Requirements

Cash deposited with clearing organizations or segregated under federal and other regulations or requirements (“restricted cash”) includes cash segregated in compliance with federal and other regulations and funds deposited by customers.

Collateralized Financings

Securities borrowed, Securities purchased under agreements to resell (“reverse repurchase agreements”), and Securities loaned are treated as collateralized financings. Reverse repurchase agreements are carried on the statement of financial condition at the amounts of cash paid, plus accrued interest. Securities borrowed and Securities loaned are recorded at the amount of cash collateral advanced or received. For additional information, see Notes 3 and 5, respectively.

The Company manages credit exposure arising from such transactions by, in appropriate circumstances, entering into master netting agreements and collateral agreements with its counterparties. These agreements provide the Company, with the right to net a counterparty’s rights and obligations under the agreement and to liquidate and set-off collateral held by the Company against the net amount owed by the counterparty.

The Company’s policy is generally to take possession of securities purchased or borrowed in connection with reverse repurchase agreements and securities borrowed transactions, respectively, and to receive cash and securities delivered under repurchase agreements or securities loaned transactions (with rights of rehypothecation).

For information related to offsetting of certain collateralized transactions, see Note 5.

Receivables and Payables – Customers

Receivables from customers primarily include margin loans (net of related customer cash and short sale proceeds). Payables to customers primarily include cash and short sale activity (net of related customer margin loans), and margin requirements.

Customers' securities transactions are recorded on a settlement date basis. Securities owned by customers, including those that collateralize margin loans, are not reflected on the statement of financial condition.

Receivables and Payables – Brokers, Dealers, and Clearing Organizations

Receivables from and payables to brokers, dealers and clearing organizations primarily include margin requirements, amounts on unsettled trades, and amounts for securities failed to deliver by the Company to the purchaser or failed to receive by the Company from the seller by the settlement date. Receivables and payables arising from unsettled trades are reported on a net basis.

Receivables from brokers, dealers and clearing organizations also include receivables from institutions and related parties participating in the Company's cash sweep programs whereby the Company has satisfied customer disbursements and is awaiting next day settlement of such customer redemptions. For additional information, see Notes 3.

Goodwill and Intangible Assets

The Company tests goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist. The Company tests goodwill for impairment at the reporting unit level, which is at the Company level. For both the annual and interim tests, the Company has the option to either (a) perform a quantitative impairment test or (b) first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, in which case the quantitative test would be performed.

When performing a quantitative impairment test, the Company compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit is less than its carrying amount, the goodwill impairment loss is equal to the excess of the carrying value over the fair value, limited by the carrying amount of goodwill allocated to that reporting unit.

The estimated fair value of the reporting unit is derived based on valuation techniques the Company believes market participants would use for the reporting unit. The estimated fair values are generally determined by utilizing a discounted cash flow methodology.

Goodwill is not amortized. Finite lived intangible assets are amortized over their estimated useful lives and reviewed for impairment on an interim basis when impairment indicators are present.

Internally Developed Software, Net

The costs of internally developed software that qualify for capitalization are included in Other assets in the statement of financial condition. For qualifying internal-use software costs, capitalization begins when the conceptual formulation, design and testing of possible software project alternatives is complete and management authorizes and commits to funding the project. The Company does not capitalize pilot projects and projects where it believes that future economic benefits are less than probable. Technology development costs incurred in the development and enhancement of software used in connection with services provided by the Company that do not otherwise qualify for capitalization treatment are expensed as incurred. Completed projects are carried at cost and amortized on a straight-line basis over their estimated useful lives of four years.

Fair Value of Financial Instruments

The Company is required to disclose the fair value of its financial instruments not measured at fair value on the financial statements, see Note 4. A description of the Company's method for determining the fair value for this required disclosure follows.

Fair Value Measurement – Definition and Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches and establishes a hierarchy for inputs used in measuring fair value that requires the most observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability that were developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect assumptions the Company believes other market participants would use in pricing the asset or liability that are developed based on the best information available in the circumstances. The fair value hierarchy is broken down into three levels based on the observability of inputs as follows, with Level 1 being the highest and Level 3 being the lowest.

Level 1. Valuations based on quoted prices in active markets that the Company has the ability to access for identical assets or liabilities. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2. Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3. Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Income Taxes

Deferred tax assets and liabilities are recorded based upon the temporary differences between the financial statement and income tax bases of assets and liabilities using currently enacted tax rates in effect for the year in which the differences are expected to reverse.

The Company recognizes net deferred tax assets to the extent that it believes these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. When performing the assessment, the Company considers all types of deferred tax assets in combination with each other, regardless of the origin of the underlying temporary difference. If a deferred tax asset is determined to be unrealizable, a valuation allowance is established. If the Company subsequently determines that it would be able to realize deferred tax assets in excess of their net recorded amount, it would make an adjustment to the deferred tax asset valuation allowance.

Uncertain tax positions are recorded on the basis of a two-step process whereby (i) the Company determines whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (ii) for those tax positions that meet this threshold, the Company recognizes the largest amount of tax benefit that is more likely than not to be realized upon ultimate settlement with the related tax authority.

Deferred Compensation Plans

Eligible current and former employees of the Company participate in various deferred stock-based and cash-based compensation plans. Amounts payable for deferred compensation plans are included in Other liabilities and accrued expenses.

The deferred cash-based compensation plans provide a return to the plan participants based upon the performance of various referenced investments, with amounts payable adjusted for changes in the fair value of the referenced investments that employees select.

Accounting Updates Adopted in 2021

Simplifying the Accounting for Income Taxes

In December 2019, the FASB amended the guidance to simplify the accounting for income taxes as part of its initiative to reduce complexity in accounting standards. The amendments remove certain exceptions to the general income tax accounting principles and provides for both consistency in application of and simplification for other areas within U.S. GAAP by clarifying and amending existing guidance. This update was adopted as of January 1, 2021, and did not have a material impact on the Company's statement of financial condition.

Accounting Development Updates

The FASB has issued certain accounting updates that apply to the Company. During the six months ended June 30, 2021, accounting updates were assessed and determined to be either not applicable or are not expected to have a significant impact on the Company’s statement of financial condition.

3. Related Party Transactions

The Company and the Parent are parties to a Master Services Agreement (MSA) under which the Parent provides the Company with technology infrastructure and development, facilities, back-office functions and general and administrative support.

The Parent also provides software development services to the Company under the terms of the MSA. The amount of internally developed software purchased from the Parent is included in Other Assets in the statement of financial condition. See Note 7 for additional details on internally developed software.

The Company has an agreement with MSSG, an affiliated service entity, to provide the Company with certain services, including infrastructure group support, information processing, communications and occupancy and equipment.

The Company has a Tax Sharing Agreement with the Ultimate Parent as described further in Note 10.

The Company has an intercompany service agreement with ETF, under which the Company provides ETF personnel and technology support.

The Company enters into collateralized financings with MS&Co, an affiliated broker-dealer.

The Company primarily relies on customer payables and securities loaned to provide liquidity and to fund margin lending. The Company also maintains unsecured, uncommitted lines of credit with the Ultimate Parent and the Parent which may be used for the Company's working capital and back-up liquidity requirements. These lines have no credit limits or maturity dates. There were no outstanding borrowings under either of these lines at June 30, 2021.

The Company offers cash sweep products, collectively the Sweep Deposit Accounts (SDA), which transfer certain customer uninvested cash balances to several affiliated banks, ETB, ETSB, MSBNA and MSPBNA. The affiliated banks pay the Company a fee at a negotiated rate based on the average SDA balances.

The Company provides customer support services for deposit and banking products under an agreement with ETB.

The Company provides automated order facilitation, custody, account administration and other related services under an agreement with ETCM, an affiliated company that provides investment research for certain of the Company's offerings.

The Company pays transfer agent fees on behalf of customers of ETFCS, an affiliated company. These fees are reimbursed by ETFCS following repayment from their customers per the terms of individual agreements.

The Company has an intercompany service agreement with ETSB, under which the Company provides distribution and other services for third-party mutual funds which may be distributed to and held by customers of ETSB.

Customer support services, account opening, and other processing services are provided to the Company under agreements with ETIS, an affiliated company.

		At June 30, 2021
Assets and receivables from affiliated companies:		
Cash	$	36
Reverse repurchase agreements		1,950
Securities borrowed		155
Receivables - Brokers, dealers and clearing organizations		233
Receivables - Affiliates		8
Other assets		36
Liabilities and payables to affiliated companies:		
Securities loaned	$	2,857
Payables - Affiliates		42
Other liabilities and accrued expenses		47

4. Fair Value of Financial Instruments Not Measured at Fair Value

The table below presents the carrying value, fair value and fair value hierarchy category of certain financial instruments that are not measured at fair value in the Company’s statement of financial condition. The fair value of items classified as Level 2 in the table below were estimated to approximate carrying value due to their short-term nature.

Financial Instruments Not Measured At Fair Value

	June 30, 2021				
		Fair Value			
	Carrying Value	Level 1	Level 2	Level 3	Total
Financial Assets					
Cash	$ 320	$ 320	$ —	$ —	$ 320
Restricted cash	748	748	—	—	748
Reverse repurchase agreements	1,950	—	1,950	—	1,950
Securities borrowed	947	—	947	—	947
Receivables:					
Customers	16,795	—	16,795	—	16,795
Brokers, dealers and clearing organizations	370	—	370	—	370
Fees, interest and other	24	—	24	—	24
Affiliates	8	—	8	—	8
Financial Liabilities					
Securities loaned	$ 2,886	$ —	$ 2,886	$ —	$ 2,886
Payables:					
Customers	15,880	—	15,880	—	15,880
Brokers, dealers and clearing organizations	106	—	106	—	106
Affiliates	42	—	42	—	42
Other liabilities and accrued expenses	211	—	211	—	211

The previous table excludes all non-financial assets and liabilities, and certain financial instruments.

5. Collateralized Transactions

The Company enters into reverse repurchase agreements with MS&Co for the exclusive benefit of customers pursuant to SEA Rule 15c3-3; and securities borrowed and securities loaned transactions with counterparties to, among other things, acquire securities to cover short positions and settle other securities obligations, accommodate customers' needs, and meet regulatory and liquidity requirements.

The Company monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest and requests or posts additional collateral, as provided under the applicable agreement to ensure such transactions are adequately collateralized, or that excess collateral is returned.

The risk related to a decline in the market value of collateral pledged or received is managed by setting appropriate market-based margin requirements. Increases in collateral margin calls on securities loaned transactions due to market value declines may be mitigated by increases in collateral margin calls on securities borrowed transactions with similar quality collateral. Additionally, the Company may request lower quality collateral pledged be replaced with higher quality collateral through collateral substitution rights in the underlying agreements.

For certain of the Company's securities lending transactions, the Company uses a program with a clearing organization that guarantees the return of collateral. The Company monitors the market value of the securities borrowed and loaned using collateral arrangements that require additional collateral to be obtained from or excess collateral to be returned to the counterparties based on changes in market value in order to maintain specified collateral levels.

Securities borrowed also includes cash collateral provided to customers for fully paid lending. The fully paid lending program offered by the Company allows customers to earn income on certain securities when they permit the Company to lend these securities.

The Company actively manages its securities loaned transactions in a manner that reduces the potential refinancing risk of securities loaned transactions of less liquid assets and also considers the quality of collateral when negotiating collateral eligibility with counterparties.

Offsetting of Collateralized Transactions

	At June 30, 2021				
	Gross Amounts	Amounts Offset	Net Amounts Presented	Amounts Not Offset[1]	Net Amounts
Assets:					
Reverse repurchase agreement	$ 1,950	$ —	$ 1,950	$ (1,950)	$ —
Securities borrowed[2]	947	—	947	(931)	16
Liabilities:					
Securities loaned[3,4]	$ 2,886	$ —	$ 2,886	$ (2,818)	$ 68

1. Amounts relate to master netting agreements that have been determined by the Company to be legally enforceable in the event of default but where certain other criteria are not met in accordance with applicable offsetting accounting guidance.
2. Included in the gross amounts of cash collateral paid for securities borrowed is $152 at June 30, 2021 transacted through a program with a clearing organization, which guarantees the return of cash to the Company. For presentation purposes, these amounts presented are based on the counterparties under the Company's master securities loan agreements.
3. Included in the gross amounts of cash collateral received for securities loaned is $4 at June 30, 2021 transacted through a program with a clearing organization, which guarantees the return of securities to the Company. For presentation purposes, these amounts presented are based on the counterparties under the Company's master securities loan agreements.
4. The company's securities loaned transactions represent equities with an overnight and open maturity.

Customer Margin Lending

The Company provides margin lending arrangements which allow customers to borrow against the value of qualifying securities. Customer receivables representing margin loans are included within Receivables - Customers in the Company's statement of financial condition. Under these agreements and transactions, the Company receives collateral, including U.S. Treasury and agency securities, corporate and other debt, and corporate equities. Margin loans are collateralized by customer-owned securities held by the Company. The Company monitors required margin levels and established credit terms daily and, pursuant to such guidelines, requires customers to deposit additional collateral, or reduce positions, when necessary.

Margin loans are extended on a demand basis and generally are not committed facilities. Factors considered in the review of margin loans are the amount of the loan, the intended purpose, the degree of leverage being employed in the account and the amount of collateral, as well as an overall evaluation of the portfolio to ensure proper diversification or, in the case of concentrated positions, appropriate liquidity of the underlying collateral or potential hedging strategies to reduce risk.

Underlying collateral for margin loans is reviewed with respect to the liquidity of the proposed collateral positions, valuation of securities, historic trading range, volatility analysis and an evaluation of industry concentrations. For these transactions, adherence to the Company's collateral policies significantly limits its credit exposure in the event of a customer default. The Company may request additional margin collateral from customers, if appropriate, and, if necessary, may sell securities that have not been paid for or purchase securities sold but not delivered from customers.

Fair Value of Collateral Received with Right to Sell or Repledge

	At June 30, 2021
Collateral received with right to sell or repledge	$ 26,313
Collateral that was sold or repledged[1]	4,874

1. Does not include securities segregated under federal and other regulations or requirements.

6. Goodwill and Intangibles

Goodwill

The Company's next annual goodwill impairment test is as of July 1, 2021 and is currently being performed. There have been no changes in the carrying amount of the Company's goodwill, which was $3,609 at June 30, 2021. Adverse market or economic events could result in impairment charges in future periods.

Intangible Assets

At June 30, 2021, the Company had intangible assets of $2,709. There was no addition to the carrying value of the Company's other intangible assets during the six months ended June 30, 2021.

Intangible Assets with Finite Lives

	At June 30, 2021		
	Gross Amount	Accumulated Amortization	Net Amount
Customer relationships	$ 2,579	$ (108)	$ 2,471
Core deposit intangibles	255	(17)	238
Total	$ 2,834	$ (125)	$ 2,709

7. Internally Developed Software

At June 30, 2021, the Company had $210 of internally developed software, net, which was included in Other assets in the statement of financial condition. This includes $130 net of internally developed software that is revenue generating or related to past acquisitions. This also includes $80 net of additional non-revenue generating internally developed software and purchased software, including $37 of costs associated with internally developed software in the process of development for which amortization had not begun.

8. Guarantees and Contingencies

Guarantees

The Company clears its mutual fund transactions on an omnibus basis through a third-party clearing broker-dealer. The Company has agreed to indemnify its third-party clearing broker-dealer for losses to the extent sustained in connection with providing the omnibus clearing services and caused by certain acts or omissions of the Company, including any breach or default under the various relevant agreements. No such indemnification payments were made during the six months ended June 30, 2021. The Company has determined that its liability under this arrangement is not reasonably estimable or probable. Accordingly, no contingent liability is carried in the statement of financial condition for these transactions.

Contingencies

Legal

In addition to the matters described below, in the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the entities that would otherwise be the primary defendants in such cases are bankrupt or are in financial distress. While the Company has identified below proceedings that the Company believes to be material, individually or collectively, there can be no assurance that additional material losses will not be incurred from claims that have not yet been asserted or are not yet determined to be material.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company's business, and involving, among other matters, sales and trading activities, financial products or offerings sold by the Company, and accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. Where available information indicates that it is probable a liability had been incurred at the date of the statement of financial condition and the Company can reasonably estimate the amount of that loss, the Company accrues the estimated loss by a charge to income.

In many proceedings and investigations, however, it is inherently difficult to determine whether any loss is probable or even possible, or to estimate the amount of any loss. For certain legal proceedings and investigations, the Company cannot predict with certainty if, how or when such proceedings or investigations will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for proceedings and investigations where the factual record is being developed or contested or where plaintiffs or government entities seek substantial or indeterminate damages, restitution, disgorgement or penalties. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, determination of issues related to class certification and the calculation of damages or other relief, and by addressing novel or unsettled legal questions relevant to the proceedings or investigations in question, before a loss or additional loss or range of loss or additional range of loss can be reasonably estimated for a proceeding or investigation.

Subject to the foregoing, and other than the matters referred to in the following paragraphs, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of such proceedings and investigations will not have a material adverse effect on the financial condition of the Company.

On May 13, 2019, the Company was named as a respondent in an arbitration which is pending before FINRA Dispute Resolution. The Statement of Claim alleges that the Company violated Section 10(b) of the Securities Exchange Act, committed common law fraud, breached fiduciary duties, breached contractual duties, failed to supervise, and were negligent in the maintenance of the claimant's accounts. The claim alleges damages of $225 and relates to margin liquidations from the claimant's accounts in February 2018.

On August 17, 2020, certain employees and officers of a client of the Company filed a Statement of Claim with FINRA Dispute Resolution alleging that the Company mishandled certain tax sales of restricted stock grants in March 2020. Claimants allege breach of contract, breach of fiduciary duties, and negligence in the manner in which the Company liquidated positions for tax purposes. The amount of damages claimed were not specified.

On August 18, 2020, the Company was named as a defendant in a putative class action styled *Benjamin Whitesides v. E*TRADE Securities LLC and E*TRADE Futures LLC* which is pending in the United States District Court for the District of Northern California. The claim alleged that certain futures customers were unable to close futures contracts on certain publicly traded oil futures contracts, when the price for such contracts traded at negative values. The complaint alleges breach of contract, breach of fiduciary duties, negligence and violations of various California statutes because the Company allegedly failed to provide a mechanism to close positions after oil futures prices turned negative. The complaint seeks, among other relief, certification of the class of plaintiffs and treble damages. On December 11, 2020, the Company moved to dismiss the First Amended Complaint. On July 21, 2021, the case was dismissed with prejudice and Plaintiffs have waived their rights of appeal.

9. Risk Management

Risk is an inherent part of the Company's business activities. Management believes effective risk management is vital to the success of the Company's business activities. Accordingly, the Company has policies and procedures in place to identify, measure, monitor, advise, challenge and control the principal risks involved in the activities of its business and support functions. The principal risks involved in the Company's business activities include credit, operational, model, compliance, cybersecurity, liquidity, strategic and reputational risk. The Company's risk management policies and related procedures are aligned with the risk appetite of the Ultimate Parent and its consolidated subsidiaries. These policies and related procedures are administered on a coordinated global and legal entity basis with consideration given to each subsidiary's, including the Company's, specific capital and regulatory requirements. For the Risk Management discussion which follows, the term "Company" includes the Ultimate Parent and its subsidiaries.

The cornerstone of the Company's risk management philosophy is the pursuit of risk-adjusted returns through prudent risk-taking that protects the Company's capital base and franchise. This is implemented utilizing five key principles: integrity, comprehensiveness, independence, accountability, and transparency. To help ensure the efficacy of risk management, which is an essential component of the Company's reputation, senior management requires thorough and frequent communication and the appropriate escalation of risk matters. The fast-paced, complex, and constantly evolving nature of global financial markets requires the Company to maintain a risk management culture that is incisive, knowledgeable about specialized products and markets, and subject to ongoing review and enhancement.

Credit Risk

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations to the Company. Credit Risk includes Country Risk, which is the risk that events in, or affect a foreign country (any country other than the U.S.) might adversely affect the Company. The Company primarily incurs credit risk exposure to institutions and individuals. This risk may arise from a variety of business activities, including, but not limited to, extending credit to clients through lending commitments; providing short- or long-term funding that is secured by physical or financial collateral whose value may at times be insufficient to fully cover the loan repayment amount; posting margin and/or collateral to clearinghouses, clearing agencies, exchanges, banks, securities firms and other financial counterparties; placing funds on deposit at other financial institutions to support its clearing and settlement obligations; and investing or trading in securities and loan pools, whereby the value of these assets may fluctuate based on realized or expected defaults on the underlying obligations or loans. This type of risk requires credit analysis of specific counterparties, both initially and on an ongoing basis. The Company also incurs credit risk through margin and other customer securities-based lending transactions, which are collateralized by securities.

The Company establishes practices to evaluate, monitor and control credit risk exposure both within and across business activities. The Company's credit risk exposure is actively managed by credit professionals (and the Business Unit's Risk Management, as appropriate) who monitors risk exposures, including margin loans and credit-sensitive, higher risk transactions.

The Company is responsible for ensuring timely and transparent communication of material credit risks, approving certain extensions of credit and escalating of risk concentrations to appropriate senior management.

Operational Risk

Operational risk refers to the risk of loss, or of damage to the Company's reputation, resulting from inadequate or failed processes or systems, from human factors or from external events (e.g., fraud, theft, legal and compliance risks, cyber attacks or damage to physical assets). The Company may incur operational risk across the full scope of its business activities, including revenue-generating activities (e.g., providing financial advice) and support and control groups (e.g., information technology and trade processing).

The Company's operational risk framework is established to identify, measure, monitor and control risk. Effective operational risk management is essential to reducing the impact of operational risk incidents and mitigating legal, regulatory and reputational risks. The framework is continually evolving to account for changes in the Company and to respond to the changing regulatory and business environment.

Model Risk

Model risk refers to the potential for adverse consequences from decisions based on incorrect or misused model outputs. Model risk can lead to financial loss, poor business and strategic decision making or damage to the Company's reputation. The risk inherent in a model is a function of the materiality, complexity and uncertainty around inputs and assumptions. Model risk is generated from the use of models impacting financial statements, regulatory filings capital adequacy assessments and the formulation of strategy.

Sound model risk management is an integral part of the Company's Risk Management Framework. Model Risk Management (MRM) is a distinct department in Risk Management responsible for the oversight of model risk. MRM establishes a model risk tolerance in line with the Ultimate Parent's risk appetite. The tolerance is based on an assessment of the materiality of the risk of financial loss or reputational damage due to errors in design, implementation and/or inappropriate use of models. The tolerance is monitored through model-specific and aggregate business-level assessments, which are based upon qualitative and quantitative factors.

A guiding principle for managing model risk is the "effective challenge" of models. The effective challenge of models is defined as critical analysis by objective, informed parties who can identify model limitations and assumptions and drive appropriate changes. MRM provides effective challenge of models, independently validates and approves models for use, annually recertifies models, identifies and tracks remediation plans for model limitations and reports on model risk metrics. The department also oversees the development of controls to support a complete and accurate Company-wide model inventory.

Liquidity Risk

Liquidity risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity risk also encompasses the Company's ability (or perceived ability) to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern. Generally, the Company incurs liquidity and funding risk as a result of its trading, lending, investing and client facilitation activities.

The Company's Liquidity Risk Management Framework is critical to help ensure that the Company maintains sufficient liquidity reserves and durable funding sources to meet the Company's daily obligations and to withstand unanticipated stress events. The Liquidity Risk Department ensures transparency of material liquidity and funding risks, compliance with established risk limits and escalation of risk concentrations to appropriate senior management. To execute these responsibilities, the Liquidity Risk Department establishes limits in line with its risk appetite, identifies and analyzes emerging liquidity and funding risks to ensure such risks are appropriately mitigated, monitors and reports risk exposures against metrics and limits, and reviews the methodologies and assumptions underpinning its Liquidity Stress Tests to ensure sufficient liquidity and funding under a range of adverse scenarios.

10. Income Taxes

The Company is a single-member limited liability company that is treated as a disregarded entity for federal income tax purposes. As such, the Company has a Tax Sharing Agreement with the Ultimate Parent in order to record its related current and deferred federal, state and local taxes. The Company is included in the consolidated federal income tax return filed by the Ultimate Parent.

Federal income taxes have generally been provided on a modified separate entity basis. The Company is included in the combined state and local income tax returns with the Ultimate Parent and certain other subsidiaries of the Ultimate Parent. State and local income taxes have been provided on separate entity income at the effective tax rate of the Company's combined filing group.

In accordance with the terms of the Tax Sharing Agreement, current taxes (federal, combined and unitary states) are settled periodically with the Ultimate Parent, who pays these taxes on behalf of the Company.

The Company is subject to the income and indirect tax laws of the U.S., its states and municipalities in which the Company has significant business operations. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant governmental taxing authorities. The Company must make judgments and interpretations about the application of these inherently complex tax laws when determining the provision for income taxes and the expense for indirect taxes and must also make estimates about when certain items affect taxable income in the various tax jurisdictions. Disputes over interpretations of the tax laws may be settled with the taxing authority upon examination or audit. The Company periodically evaluates the likelihood of assessments in each taxing jurisdiction resulting from current and subsequent years' examinations, and unrecognized tax benefits related to potential losses that may arise from tax audits are established in accordance with the relevant accounting guidance. Once established, unrecognized tax benefits are adjusted when there is more information available or when an event occurs requiring a change.

It is reasonably possible that significant changes in the balance of unrecognized tax benefits may occur within the next 12 months. At this time, however, it is not possible to reasonably estimate the expected change to the total amount of unrecognized tax benefits and the impact on the Company's effective tax rate over the next 12 months.

The Company, through its inclusion in the return of the Ultimate Parent, is under continuous examination by the IRS and other tax authorities in certain states in which the Company has significant business operations, such as New York.

The Company believes that the resolution of these tax examinations will not have a material effect on the statement of financial condition.

11. Regulatory Requirements

Regulatory Capital

The Company is subject to the Uniform Net Capital Rule (the Rule) under the Securities Exchange Act of 1934 administered by the SEC and FINRA, which requires the maintenance of minimum net capital. The Company has elected to use the alternative method permitted by the Rule, which requires that the Company maintain net capital equal to the greater of $250,000 or 2% of aggregate debit balances arising from customer transactions. Under the alternative method, a broker-dealer may not repay subordinated borrowings, pay cash dividends, or make any unsecured advances or loans to its Ultimate Parent or employees if such payment would result in net capital of less than 5% of aggregate debit balances or less than 120% of its minimum dollar amount requirement. At June 30, 2021, the Company had net capital of $1,836 (9.70% of aggregate debit balances), which exceeded the minimum requirement by $1,457.

Customer Protection

As a registered U.S. broker-dealer, the Company is subject to the customer protection provisions under SEA Rule 15c3-3, which requires the Company to compute a reserve requirement for customers and deposit cash or securities into a special reserve bank account for the exclusive benefit of customers. As of June 30, 2021, the Company had $2,218 in the special reserve bank account for the exclusive benefit of customers consisting of $268 in cash and $1,950 in qualified U.S. Government securities. These qualified securities were sourced from reverse repurchase agreements in the Company's statement of financial condition.

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Glossary of Common Acronyms

ETB	E*TRADE Bank
ETCM	E*TRADE Capital Management, LLC
ETF	E*TRADE Futures LLC
ETFCS	E*TRADE Financial Corporate Services, Inc.
ETIS	E*TRADE Information Services, LLC
ETSB	E*TRADE Savings Bank
FASB	Financial Accounting Standards Board
FINRA	The Financial Industry Regulatory Authority
IRS	Internal Revenue Service
MSBNA	Morgan Stanley Bank, N.A
MS&Co.	Morgan Stanley & Co. LLC
MSPBNA	Morgan Stanley Private Bank, National Association
MSSG	Morgan Stanley Services Group Inc.
SEA	U.S. Securities and Exchange Act
SEC	U.S. Securities and Exchange Commission
SIPC	Securities Investor Protection Corporation
U.S.	United States of America, which includes the District of Columbia, Puerto Rico, and the U.S. territories and in the United States of America
U.S. GAAP	Accounting principles generally accepted in the United States of America