

**MANAGEMENT DISCUSSION SECTION**

Operator: Welcome to E\*TRADE Financial Corporation's Second Quarter 2008 Business Update Call. At this time, all participants have been placed in a listen-only mode. [Operator Instructions].

I've been asked to begin this call with the following Safe Harbor statement. During this conference call, the company will be sharing with you certain projections or other forward-looking statements regarding future events, or its future performance. E\*TRADE Financial cautions you that certain factors, including risks and uncertainties referred to in the 10-Ks, 10-Qs, and other reports periodically filed with the Securities and Exchange Commission could cause the Company's actual results to differ materially from those indicated by its projections or forward looking statements. This call will present information as of July 22, 2008. Please note that E\*TRADE disclaims any duty to update any forward looking statements made in the presentation.

In this call, E\*TRADE Financial may also discuss some non-GAAP financial measures in talking about its performance. These measures will be reconciled to GAAP either during the course of this call, or in the company's press release which can be found on its website at [etrade.com](http://etrade.com). This call is being recorded. Replays of this call will be available via phone, webcast, and podcast beginning today at approximately 7:00p.m. eastern time. The call is being webcast live at [etrade.com](http://etrade.com). No other recordings or copies of this call are authorized or may be relied upon. I'll now turn the call over to Don Layton, Chairman and Chief Executive Officer of E\*TRADE Financial Corporation who is joined by Matt Audette, acting Chief Financial Officer, and Bob Burton, President of E\*TRADE Bank. Mr. Layton, please go ahead.

**Donald H. Layton, Chairman and Chief Executive Officer**

Thank you and welcome, everyone, to our second quarter conference call. I want to make three points today. One, our retail franchise, which is core to E\*TRADE, is strong, growing and competitive, with our customers well engaged despite the overall market environment, and is producing good profits as disclosed in our segment reporting. Two, we continue to execute aggressively on our balance sheet repair plan. The overall environment in which that plan is being executed has deteriorated as credit losses in our portfolio are somewhat higher than predicted, as you all no doubt expected given the economy and the financial and housing markets. But I am pleased that the plan is proving robust enough and our execution strong enough, that our balance sheet exposures are still manageable and our capital base solid.

I will give you more details in a few minutes. Excuse me. I think you'll be impressed with what you hear.

And three, we are executing well in all aspects of our turn-around plan and continue to make progress towards returning to profitability from continuing operations.

Now, let me go into more detail on these points. First, our retail franchise. Despite considerable market turbulence, our franchise has really demonstrated its strength and appeal again this quarter. To that end, DARTs were up 7% year-over-year, despite the disruption from late last year. Net asset flows were \$900 million positive this quarter, or 1.8 billion if you adjust for the sale of our RAA business. This is consistent with the level of customer asset inflows, excuse me a minute -- we were able to generate prior to the credit crisis in the second quarter last year.

Margin was up 700 million or 11% over last quarter, illustrating the strong customer engagement we are experiencing. Customer cash and deposits ended the quarter at 33.7 billion, down less than 1% from last quarter, driven by strong net buying in the equity markets by our customers. Note that customer cash and deposits is up 1.8 billion from last year's low.

Net buying. U.S. retail customers were net buyers of approximately 2.2 billion of securities in Q2, and just over 3 billion year-to-date. The strong net buying on the part of our customers with this quarter makes us even more pleased with the level of customer cash we continue to hold. Customer cash levels are obviously net of this strong buying activity during the quarter.

Retail segment income generated 170 million of pre-tax profits. While there is some noise in here, including some insurance recoveries, the numbers made clear that the retail franchise is strong, well run, and growing.

Customers are up 22,000 from last quarter, and up 90,000 from last year. Target segment accounts, our most profitable and important accounts, are up 14,000 from last quarter and 4,000 from last year. This is the metric that we have been watching closely, since the previous two quarters showed a decline in target segment accounts. I consider this to be another important indicator of customer engagement. Total accounts were up 30,000 from last quarter and 196,000 from last year.

We are continuing to innovate and invest in our world class retail franchise. This quarter you saw the launch of E\*TRADE Mobile Pro, a leading-edge platform for use with the BlackBerry smartphone that offers our customers many of the features available to them on their desktops.

Let me make two quick comments about customer behavior so far in the month of July. During a tumultuous market period, we can confirm that July trading volumes are up nicely compared to June, about 12%, and customer cash and deposits are flat since June 30. We will of course provide more detail of that July activity with our usual metrics release in mid-August.

To summarize, I am very pleased with the continued strong levels of customer engagement within our core retail franchise in the second quarter. Our investments in products, service and marketing are obviously paying off as we continue to build this very valuable business. We absolutely will keep this franchise strong and competitive.

Now, just a technical note on our metrics. We have elected this quarter, given the sale of our Canadian business and the exit of our retail mortgage business, both of which have been announced, to break out our metrics into continuing and discontinued operations. We're no longer counting Canadian retail accounts or mortgage accounts in our account metrics. We've also implemented a methodology improvement to how we count customers that is also reflected this quarter. This has no impact on accounts, however.

Second, let's turn to our objective of repairing the balance sheet. The plan to do so has five pillars. Let me go through them in some detail and show you why we say that it is being executed upon strongly. The first pillar is to keep a healthy retail franchise. As it generates a strong level of bank profitability before credit costs, mainly from the low cost of sweep-related deposits and from brokerage customer margin loans.

As disclosed on page 10 of the press release today, and this is for the first time although these numbers could have been developed from various regulatory filings, our core retail franchise is helping the bank to produce approximately 200 million of profit per quarter before credit costs. So, the financial dynamics here are simple. Each quarter this roughly 200 million level will absorb a significant amount of credit cost, before those costs impact the bank's capital at all. And as you can see from our metrics, this pre-credit cost bank profitability has been relatively stable over time, with this quarter's results down just 3% over last year's comparable figure. In fact, these pre-credit cost profits have absorbed approximately 70% of loan provision and securities losses for the first six months of 2008. And this includes a reserve buildup in the first half of the year of \$128 million.

Over the next year, and in the full three-year forecast cumulative loss period, such profits are expected to be the single biggest source of funding to absorb our credit costs.

The second pillar is to keep the bank healthy in terms of capital. At June 30 we had capital ratios of 6.7% that's tier one, and 12.2% that's risk based. In addition, a powerful metric we are using is to watch the amount of capital that is above and beyond what the regulators defined as well-capitalized for risk based capital. As of June 30, this was approximately \$620 million, a very significant cushion when you recall it is excess above well-capitalized.

This metric also reflects our success in reducing the size and risk of our bank balance sheet. Even with the high credit costs in the second quarter, which may have peaked, a topic I'll address in a few minutes, we have been able to keep our excess capital levels very strong; I think you will agree. It is in fact our expectation that at our predicted level of credit losses, or even with losses moderately higher than that level, the bank is likely to be self-sustaining in terms of capital, not requiring any additional funds from the parent, ETFC. We expect to have excess risk-based capital at the bank of approximately 700 to \$800 million by year-end. Note that this expectation is before any potential downstreams of capital from the holding company, made possible by the asset sales previously disclosed, although such sales clearly provide us with the flexibility to do so, if needed.

The third pillar is to aggressively manage the loan portfolios for value. Bob Burton will discuss these issues in a moment. For example, we now have reduced our undrawn home equity lines by 49% since last year to \$3.7 billion, and have added another 17 million in loan putbacks this quarter. Bob will also be talking about the fundamental risk characteristics of the portfolio.

The fourth pillar is to reduce debt at the parent level. Although the parent currently has more leverage than we want for our long-term health, it has no liquidity needs to meet debt maturities, as there is no CP program or any maturities until 2011. We continue to pursue debt for equity exchanges as the most shareholder-friendly method of reducing the debt. Since the first of the year we have retired \$121 million in debt-fee exchanges, representing 9 million in annualized coupon savings, with 20 million in gains generated, and 27 million shares issued at an average price of \$3.88. Beyond such exchanges we will be opportunistic about methods of reducing the debt that are shareholder-friendly.

The fifth pillar is non-core asset sales, as an inexpensive source of capital that will provide a cushion to our whole program, enabling it to absorb unexpected events to a reasonable degree. In fact it was obvious when I got to E\*TRADE that the overall environment was one where, as the saying goes, capital is king. So we jumped in this early and aggressively, executing on our plan to sell non-core assets, and have substantially surpassed our guidance of 500 million of proceeds from such sales.

The profit give-up on the over 700 million in year-to-date asset sales is approximately 30 million annually or just 4% of cash received. Given that low return on cash raised, this was a very dilution-friendly means of raising cash and capital for the parent.

The cushion that these non-core sales will provide when they close later this year is substantial. It will allow us to have excess capacity to deal with credit losses, even though we do not expect currently to need the funds for that, and for an additional source of funding to reduce debt at the parent. Our execution in which we employ this excess cash will be highlighted by nimbleness, keeping our options open and being flexible, because the environment around us is difficult and uncertain. Liquidity also continues to be strong with undrawn federal home loan bank availability of \$10.1 billion, in addition to approximately 1.8 billion of cash on the balance sheet of the bank.

Before I turn this over to Bob let me touch on some of our key credit performance metrics and trends. During the second quarter the economy financial markets and housing markets all experienced very negative trends. E\*TRADE was moderately impacted by these events. But to reiterate my earlier points, while credit losses are somewhat worse than we expected, our balance sheet exposures are manageable and our capital base is sound. Provision expense increased by

85 million over last quarter, driven by an increase in charge-offs of 73 million. 54 million of this increase was home equity related. Allowance for loan losses grew by 70 million to 636 million this quarter, reflecting our view of moderate losses over the next 12 months. We are now at the high end of our previously disclosed three year cumulative loss outlook of 1 to 1.5 billion for our home equity loan portfolio.

Delinquencies. Early stage delinquencies across our portfolio performed well for the second quarter in a row. This quarter being up by only 2%. This trend continues to be encouraging and indicates that we may have reached the peak in terms of loan delinquency.

This quarter we have separately reported our non-performing loans that are more than 180 days past due at quarter end. We thought this would be helpful since now these loans have been written down to expected recovery values, pursuant to regulatory requirements implemented earlier this year. As a result the allowance for loan losses effectively covers expected losses from our performing loans and non-performing loans that are less than 180 days delinquent. Allowances percent of non-performing loans or the coverage ratio for our one-to-four family portfolio declined slightly from 14.2% to 14.0% compared to last quarter.

However, if you take out the 180-plus day delinquency component of this ratio, as it has already been written down to expected value, the adjusted coverage ratio is 27% in Q2, flat, with 27% in Q1. We regard this as the more accurate economic calculation. This adjusted coverage ratio is especially important for the one-to-four family portfolio as we expect the 180-plus day bucket to grow over time due to the extensive amount of time it takes to foreclose on a property.

The coverage ratio for the home equity book increased before the adjustment to 179% from 172% last year. The adjusted ratio for home equities, in fact, was relatively flat, from 219% in Q2, from 221% in Q1. The growth in total delinquent loans continued to slow for the second quarter in a row. Our home equity book showed growth in total delinquencies of 25 million for 4% down from an increase of 8% last quarter. Our one-to-four family total delinquencies were up 85 million or 13% this quarter, significantly better than the 37% increase last quarter. Total delinquencies therefore increased by 111 million or 9% during the quarter, representing the slowest increase in four quarters. While we are pleased with the decrease in the rate of growth, delinquencies have not begun to decline as was originally predicted by our models.

Now I will turn it over to Bob Burton, president of E\*TRADE Bank.

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**Robert V. Burton, President, E\*TRADE Bank**

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Thanks, Don. We see our success today in mitigating portfolio risk as central to our confidence in the turnaround plan. Let me address our loss mitigation activities which continue to produce significant results.

As we've defined previously, these efforts include partnering with our loan servicers to increase their effectiveness, increasing our loss recovery efforts, and increasing our efforts to put back loans to sellers, for the original representations of the sellers are not matched by the fact of the loans themselves. We put back 17 million in loans this quarter, a total of 44 million year-to-date.

However, the most significant success of these efforts to date has been reducing our risk to open lines of credit. To date we have decreased this risk from 7.2 billion last year to just 3.7 billion at the end of June. This 49% reduction results from freezing lines on all accounts as they become delinquent, proactively freezing lines whenever the underlying home equity has been materially impaired, and a surprising level of prepayment on these frozen accounts, as frozen customers choose to move elsewhere for their home equity borrowing. Beyond the decrease in absolute terms, this risk inherent in the remaining open lines should be minimal. By definition, these

accounts have not been delinquent in 2008, and have not had a material deterioration in home values. More significantly, about half of these open lines are currently unused; that is, they have no current balance. And finally, the remaining open lines have strong credit characteristics, with a 769 average FICO score and an updated CLTV of only 67%.

As we project the performance of the portfolio going forward, there are additional elements that support our confidence that the downside risk in the portfolio is limited, particularly in the makeup of the portfolio. In general, the 2006 and 2007 vintages are the worst performing in the markets. However we have a significantly smaller exposure to the 2007 vintage, the vintage that is just beginning to ramp up in delinquency and loss within the market.

Let me give you some specifics: First, our 2007 loan vintage represents only 11% of our total home equity loan portfolio by quarter end. We believe this is less than most other firms to which we are often compared. Second, we tightened our credit criteria for loans purchased during 2007. We significantly reduced our exposure to loans with CLTDs in excess of 90%. Loans that are proven to be exceedingly high risk. Third, in quality, the 2007 vintage has been outperforming industry benchmarks and, when compared to our own 2006 vintage, is performing about 20% better in a more difficult environment. This limited exposure to the 2007 vintage is core to our expectation for reduced loan losses later in 2008 and beyond.

With that I'll turn it back to Don for some additional comments.

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**Donald H. Layton, Chairman and Chief Executive Officer**

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Thanks, Bob. Let me now add three additional comments to complete our discussion. First, the securities portfolio. Impairments on CMO securities were 17 million this quarter down from 27 million last quarter, related to expected downgrades by the rating agencies.

Second, deposit pricing and spread. Matt Audette will talk more about this in a minute, but I want to point out that we are very pleased that our net interest spread widened this quarter to 272 basis points from 250 basis points last quarter. We are benefiting from improved market pricing for financial assets while not having to pay unreasonable rates for retail deposits. Uninsured deposits fell this quarter from 4.8 billion to 4.4 billion.

And the last item I want to touch on is the loss taken on Fannie and Freddie preferred as we disclosed in our press release today. I wanted to give you some color on this because the loss is substantial. As previously disclosed, the company owns a long standing preferred equity investment in Fannie Mae and Freddie Mac. As of June 30 these positions had a market value of \$330 million. Subsequent to the end of the second quarter, as you all know, Fannie and Freddie experienced unprecedented price declines and volatility.

Based on concerns about continuing market instability of potential government led plans that could be materially impact the value of these securities, and given our desire to reduce our risk profile, the majority of this preferred equity investment was liquidated during July resulting in a pre-tax loss of \$83 million. This loss will be reflected in our third quarter results. As of yesterday the remaining position of 150 million had a mark-to-market unrealized loss of approximately 40 million net of hedges. Our strong bias is to continue to reduce our remaining exposure opportunistically as ownership of such securities is no longer in line with the company's strategic objectives. I want to point out that the impact of this loss on our consolidated book value is more than offset by the 400 million in gains we expect to book on the sale of Canada upon closing later this year. The capital impact of these losses was included in the previously discussed 700 to 800 million of excess risk based capital that we expect to have by year end in the bank.

So to summarize, the points I hope to leave you with today are three. One, our retail franchise is performing well despite the challenging macroeconomic environment. Two, our balance sheet repair plan is going well. Although losses in our portfolio are somewhat worse than expected our balance sheet exposures are still manageable and our capital base solid. And through our non-core asset sales, excess capital and recurring pre-provision profits of the bank we have built a significant cushion against credit scenarios that deteriorate beyond our expectations.

And three, although the current economic environment may impede our ability to return to quarterly profitability from continuing operations this year our turnaround plan is succeeding and we continue to make solid progress towards returning to that profitability.

I will now turn it over to Matt to give you some more detail around our financial results and our metrics and then my colleagues and I – my colleagues will join me to take questions.

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**Matthew J. Audette, Executive Vice President, Controller, and Acting Chief Financial Officer**

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Thanks, Don. I'd like to start by highlighting some changes made to our financial statements during the quarter. First, both our Canadian brokerage business and our lending business have been reclassified as discontinued operations. More specifically, all revenues and expenses including those of prior periods for these businesses are presented net of tax in a single line item at the bottom of our income statement. In an effort to provide transparency we added a new section to the corporate metrics table, which highlights the components of this line item. In addition, we made a formatting change to the income statement with provision for loan losses now presented as its own line item separate from revenue.

Turning now to our results for the quarter, we generated a net loss of \$95 million on total net revenue of 532 million. Total revenue is up 3 million sequentially driven primarily by a 16 million increase in net operating interest income. This increase is driven by improvement in our net interest spread which averaged 272 basis points for the second quarter, up 22 basis points sequentially.

The primary driver of this spread improvement was a decline in the average rate of paid owner deposits of 60 basis points when compared to the average deposit rate for the first quarter. We were able to accomplish this reduction rate while maintaining our deposit balances at a level consistent with the first quarter.

Commission revenue was flat quarter-over-quarter with lower DARTs offset by three additional trading days. Fees and service charges continued to decline as expected driven primarily by lower advisory fees, as a result of our sale of Retirement Advisors of America which closed during the month of April. Principal transaction revenue tracked lower market volumes and was down 10% versus last quarter. We also reported a loss on loans and securities of 16 million which was primarily driven by the impairment in our private CMO portfolio. The losses on our investment in Fannie and Freddie preferred stock previously discussed by Don will be reflected in this line item in the third quarter.

Turning to provision for loan losses, we continue to build our allowance for the provision of \$319 million, which included a reserve build of 70 million. As of the end of the second quarter our total allowance for loan losses now stands at approximately 636 million.

Total operating expenses declined this quarter by 36 million, and include the impact of our cost reduction efforts. Compensation expense is a primary driver behind these expenses reductions, and was down 27 million from last quarter. Please note that the first quarter did include 12 million in severance expenses. Excluding the declines due to these severance expenses not recurring in the second quarter, compensation expense declined 15 million, and includes the impact of our

targeted 50 million in annual run rate expense reductions. Going forward we expect compensation related expenses to remain relatively in line with the amounts reported for the second quarter.

Turning now to advertising expense, a planned seasonal reduction in our spend resulted in a decline of 15 million when compared to the first quarter. Other expenses of 20 million were lower than expected due to approximately 13 million in insurance recoveries as well as other recoveries to legal reserves. Going forward we expect this line item to return to a more normalized run rate of approximately 35 million per quarter. The results also included a 12.4 million restructuring charge related primarily to exiting certain facilities and were offset slightly by the gain on sales of Retirement Advisors of America.

Corporate interest expense was down by 5 million when compared to the first quarter, and was driven by the debt reduction from our 389 exchange program. This program has lowered our corporate debt by 121 million this year. The early extinguishment of debt line items shows income this quarter of 13 million driven primarily by gains from the retirement debt at a discount from the same three line item initiatives. Our expectations are for 700 million of debt reduction this year, including the conversion of our mandatory convertible notes and our 389-related debt reduction. This debt reduction means that run rate interest expense going into 2009 would be over 50 million less than the Q1 2008 run rate.

Turning now to discontinued operations, our results in the second quarter included 24.1 million non-cash tax benefit related to the previously announced sale of our Canadian indiscernible brokerage business. This gain resulted from the difference between a tax and book basis of this business. Generally accepted accounting principles require the recognition of the tax effects of stock basis differences once a commitment is in place to sell a subsidiary, and the subsidiary's results are presented as a discontinued operation. Continuing the discussion on tax, our losses in 2007 permitted us to file for a refund of taxes paid in 2005 and 2006. During the second quarter we received this refund which was approximately \$300 million. This cash was due principally to the bank and therefore did not impact our corporate cash levels.

That concludes the prepared remarks and we are now ready to take your questions.

**QUESTION AND ANSWER SECTION**

Operator: Thank you, sir. We will now open the floor to questions. [Operator Instructions]. And our first question comes from Roger Freeman from Lehman Brothers. Please go ahead.

<Q>: Hi guys, this is [inaudible] calling in for Roger. Could you provide us an update on your previously guided 1 to 1.5 billion cumulative loss assumption on the HELOC, and also what you think the cumulative loss would be on the first lien portfolio?

<A – Donald Layton>: Okay, hi, this is Don. We did bury in all that, we did in fact update the three-year cumulative loss for home equity. It was originally of course a 1 to \$1.5 billion range and we stated in here that it is now risen to the high end of that -- the top of that range as of June 30. So that's our latest update on that. In terms of first liens, we have never actually disclosed the three-year forecast. The reality is three-year forecasts are -- have very high uncertainty. It's very hard to predict anything for one year these days much less three because the size of the loss potential there is so much less than home equity, we just didn't want to get into that. So we have not done so.

<Q>: Okay. And as my follow up to the HELOC portfolio, have you seen any bidders in the marketplace for HELOC assets such as your portfolio and kind of where are they marking them, as in, what would be the mark-to-market if this was a mark-to-market portfolio? Thanks.

<A – Donald Layton>: Okay. First of all let me just -- for your non-follow-up question, the best thing we can do to guide you in loss expectations is to send you to the allowance figures, because the allowance of course is our forward-looking four quarter estimate and that will put you halfway through the three year plan -- projection period -- since we already are six months in. We are -- our intent is to hold the home equity portfolio so we do not actively contact the market to find its value. So I do not have a number for you. My general impression from what's going on in the market, not specifically with respect to our home equity but the mortgage assets, is there is virtually no type of activity in this kind of asset on any regular basis that anyone can have a price. The market's very distressed and I just wouldn't hazard a guess of what it might be if something came up. It's not all that directly relevant to us.

Operator: And our next question comes from Rich Repetto from Sandler O'Neill. Please go ahead.

<Q – Richard Repetto>: Good evening, guys. Hello, can you hear me?

<A – Donald Layton>: Yeah, hi, Rich, how are you?

<Q – Richard Repetto>: Hi, Don. I guess I was interested in your -- the 700 to 800 million in capital by year end, and sort of the numbers that fall behind there. Because you're saying you're going to get out, get there without down streaming any capital from the parent. And I guess, and I know you're making about 200 pre-provision, pre-tax at the bank. I guess I'm trying to get the assumption for the losses in the next two quarters because there's got to be some ballpark number to get there.

<A – Donald Layton>: Yeah, okay. Well, okay. Let's start with the dynamics. We have 620 million in excess at the end of June 30. So you're talking about an increase, so call it 100, 150 gets you the 700, 800 rate.

<Q – Richard Repetto>: Exactly, yeah.

<A – Donald Layton>: Okay. The dynamics of that are first of all, will be the profits after credit costs for the second quarter. You know now about the Fannie Freddie loss; we've disclosed that. You know about the 200 million. You can come up with your own estimate of what the second half



credit losses might be by looking at the four quarter forward looking allowance and you can take your own guess as to what the percentage of that might be in the first six months of that 12 month period.

In addition, you're going to have risk reduction at the bank. We have natural risk reduction as loans pay down in the home equity and the first mortgage portfolio. And we've had pretty good pay down level in all that. So that the natural increase in risk capital that comes from the reduction in needs to support those assets and you throw all that in and you get to the range of the 700 to 800 million we talk about.

**<Q – Richard Repetto>**: And that's -- well I did that, sort of back of the envelope during the call. And I guess the assumption when you take into account the Fannie/Freddie, the losses there, it just seems like it could be below the 200 million charge off range in the quarterly – in the back half here. And that just doesn't – given the trends, it just seemed a little bit aggressive to assume that at this point.

**<A – Donald Layton>**: Well, I'm not – we're not going to go through all the details how we come up with this because of the intricacies. There's also lots of other issues in risk based capital about tax allowances, limits on this, limits on that. But we've gone through that. We think this is within a reasonable range of error, a doable level.

Operator: And our next question comes from Howard Chen from Credit Suisse. Please go ahead.

**<Q – Howard Chen>**: Good afternoon, everyone.

**<A – Donald Layton>**: Hi.

**<Q – Howard Chen>**: Don, you went into a lot of detail on the asset quality. But just to take a step back, can you just refresh us with what is broadly driving your credit quality and provisioning assumptions? How much future home price depreciation are you factoring in? When do losses peak and how much higher are those loss rate assumptions from where we are currently?

**<A – Donald Layton>**: Okay. We have an extensive modeling process. I'm going to focus on home equity because that's where the big losses are. We have an extensive modeling process. In terms of home equity, we use – we do not come up with our own estimate. We use Case-Schiller for their futures. The current number in there -- if you did it as a national average, it's 15% over the next 12 months. Please note, we don't do it as a national average, we actually have individual portfolios in the individual metropolitan areas that they do. And so we've got that modeled in.

In terms of the economy, we're largely -- the roll rates that you assume for delinquencies, we're assuming roughly the same – we're starting at a high level because the economy is so bad now so that implicitly is a weak economy assumption in there. And that's your biggest items.

In terms of peaking, the home equity, that is -- the home equity provisions may have peaked in the second quarter. They may not. They may drag on to later in the year. What I will tell you is that the model indicates that the provisions for the second quarter are at a peak. But one must be humble in the markets these days, given what is going on. That there's a great deal of uncertainty in any kind of model forecast. So we're not turning that into -- we don't have enough confidence in that to turn it into guidance. But given the delinquencies which we've indicated are very slowly growing at this point, we think we're getting close to the peak as much as we can tell.

Our overall tone in the portfolio is not quite as pessimistic as many others who seem to have home equity. And Bob mentioned a lot of that. Number one, we don't do new originations so there's no new stuff going in. This is not a customer business per se. Number two, I can't tell you how big a deal it is that we have so little '07 in there. '07 is considered broadly in the marketplace to be even

worse quality than '06 as a broad rule, that housing prices were even higher. And we haven't made a big deal about this. But remember, we're not an originator of these loans. We have actually originated ourselves less than 10%. We're actually an investor in a diversified portfolio of the loans, some of whom originated high quality stuff and some of whom did not. So we are getting the benefit of that diversification. So we think we'll be performing better than others. And that's why we have our range at the top end of the 1.5 billion. Clearly if the economy and the home prices go worse than is built into the forecast that number could rise, but that's what it shows now.

**<Q – Howard Chen>**: Okay. That's all really helpful. And also, thanks for all the new disclosure. As my follow up, on the bank earnings before taxes and provisions, you mentioned that you generated \$204 million during the quarter. So if I look at the segment income of the entire company, you generated \$214 million, ex loan loss provisions, so does that mean that you believe you are generating \$14 million of operating income from the broker operations if you were to split up the contributions from the broker and the bank, or is that the wrong way to think about it?

**<A – Donald Layton>**: Yes, that's the wrong way. I wish this company was just as simple as just the two legal entities. It's not. I'll give you a first order of – still oversimplified item. You should think of three legal entities. You should think of the bank, you should think of the broker and you should think of the parent. The parent right now with the Citadel debt on its books and its high interest expense, is – loses – has a negative P&L. And that's what you're seeing drag down what you think of as the broker, is actually the parent. And that -- and one of the reasons we wish to in the long run reduce the debt of the parent, have the parent have a positive P&L on its own.

**<Q – Howard Chen>**: Okay, thanks.

**<A – Donald Layton>**: Next question.

Operator: And our next question comes from Mike Vinciguerra from BMO capital. Please go ahead.

**<A – Donald Layton>**: Hi, Mike.

**<Q – Michael Vinciguerra>**: What you're seeing in terms of --

Operator: Please go ahead, sir.

**<Q – Michael Vinciguerra>**: Hello?

**<A – Donald Layton>**: Yes, Mike, go on.

**<Q – Michael Vinciguerra>**: Can you hear me?

**<A – Donald Layton>**: Yes. Now we can.

**<Q – Michael Vinciguerra>**: Sorry about that. I guess I should not use this headset. But anyway, I want to ask, on the -- your growth in the brokerage business, I guess you added a net of 30,000 accounts during the quarter, but obviously you still have a relatively large spigot at the bottom where you're losing a lot of accounts. Can you give us some description of what types of accounts you're losing? Are these low value accounts, are they accounts that -- are you actually still losing some of your targeted accounts that you lost, maybe at the end of last year?

**<A – Donald Layton>**: Yeah, I am going to give you the expert here, I'm going to ask Mike Curcio who of course runs that end of the business to give you more detail.

**<A – Michael Curcio>**: Hi, Mike.

<Q – Michael Vinciguerra>: Hey, how are you?

<A – Michael Curcio>: Yeah, well, what we see if you look back from Q3, we took a big hit in January. In the beginning of Q1 we stabilized and we're back in growth mode. And as we commented before we actually are growing the target segment again. So you do see some attrition across the board. But the target segment is growing, and the business is stabilizing in growth mode.

<Q – Michael Vinciguerra>: When we went to DARTs, Mike, for the second quarter of 172, does that include the Canadian operation or is that separate?

<A – Michael Curcio>: That is separate, Mike.

<Q – Michael Vinciguerra>: Okay. And then just one other question. On the balance sheet again, your \$8.5 billion in mortgage backed securities, with Fannie and Freddie issues, is there any concern that could you face some losses on your agency paper which would have essentially been unthinkable before?

<A – Donald Layton>: Well, one hesitates to talk about uncertainty about things these days, given what's going on. We don't think that's in fact a risk we have to worry about.

Operator: And our next question comes from Mike Carrier from UBS. Please go ahead.

<Q – Michael Carrier>: Thanks. You guys provided the updated LTV ratio for the undrawn HELOCs at 67%. Can you give us what the broader portfolio -- or the portfolio that's on the books?

<A – Donald Layton>: Well, I'm not -- if you mean the home equity portfolio, page 15 of the release in the middle has quite a bit of detail on the CLTV of the home equity portfolio also cross cut with FICO scores. Overall, on average, the portfolios, the updated CLTV is 93%. Although I think the scan here is maybe more what you're after.

<Q – Michael Carrier>: No, that was the 93%, the updated, okay.

<A – Donald Layton>: Okay.

<Q – Michael Carrier>: And then just a follow-up on the bank capital. Just curious, how close can you get -- let's just say the environment gets worse on the economy and losses go up. How close can you get to -- not well capitalized, but adequately capitalized? And then second, how much more debt could you take at the parent, and then downstream into the bank before the regulators get a little uneasy?

<A – Donald Layton>: The reality is, we think that we have enough fire power between the earnings, the natural reduction in riskiness of the bank balance sheet every month with paydowns, the current excess capital and the cash coming into the parent that we don't need to borrow or raise capital to cover loan losses under a fairly wide range of assumptions. You can do the math. There's a lot of room here for extra. So we just don't see the need to do that. The parent borrowing capacity I would say just as an intellectual matter is very limited at this time.

Operator: And our next question comes from Matt Snowling from FBR Capital Markets. Please go ahead.

<Q – Matt Snowling>: Good afternoon.

<A – Donald Layton>: Hi.

**<Q – Matt Snowling>**: Just curious, going back to the capital question again. You're comfortable with being self sufficient in terms of capital going forward. Why so aggressive on the asset sales? Specifically, the Canadian operations?

**<A – Donald Layton>**: Oh, okay. The – we are comfortable that the bank, with its earnings, with its excess capital, can do – can be likely self sustaining. But this is a highly unusual environment. And it absolutely is clear from not only our own work looking at ourselves but what's going on with other companies much larger than ours that having gotten a jump on it, and selling things that we don't need at prices that quite honestly are almost too high to turn down, because they are worth so much more to other people than us versus the earnings we give up, that there will be a cushion at the parent from those sales is absolutely fundamental to surviving in such a risky period.

If you notice some other firms, the problem is if you wait for the problem to happen or something untoward to happen in the environment or for our company in particular, then you can't react quickly enough via an asset sale which is a low cost source of capital and you end up being backed into some kind of emergency equity raise at highly dilutive terms. So we think this is much smarter. And if we don't need the money for the loan losses, we absolutely have a good use for it, which is accretive, not dilutive, given the give up in earnings to pay down our debt at the parent, which we need to do anyhow. So we figure it is a win-win either way.

**<Q – Matt Snowling>**: All right. Thanks.

Operator: And our next question comes from Prashant Bhatia from CitiGroup. Please go ahead.

**<Q – Prashant Bhatia>**: Hi.

**<A – Donald Layton>**: Hi.

**<Q – Prashant Bhatia>**: You said that your delinquencies haven't declined as predicted by the models. But then you went ahead and said the models are predicting a peak in home equity next quarter. Is this based on the same model that is not working or have you made some changes that you think will make the model work?

**<A – Donald Layton>**: First of all, it's not a question of the model working. There's – you have to forecast inputs. The biggest one as an example I'll give is, of course, is Case-Schiller. And the reality is because conditions were worse than predicted by the forward looking things like Case-Schiller, obviously losses ended up being higher. Case-Schiller and everybody else have adjusted to the new environment and so we think the model still has credibility. But as I said, one must be humble in this environment and recognizing the great deal of uncertainty in any forecast, whether it's ours or someone else's so we put a fairly wide degree of trust in model output. But it's a rigorous process for accounting; it's the one we're using.

**<Q – Prashant Bhatia>**: Okay. And then just on the reserve on the first lien side it's at 52 million, so I guess that's what you're expecting over the next four quarters. But your chargeoffs this quarter were at 32 million. So how do you reconcile those two and maybe in general what's driving the huge spike in losses on the first lien side?

**<A – Donald Layton>**: Remember how we mentioned how the – just a minute here. Yeah, remember how I mentioned the regulatory accounting being – rule being implemented where you have to do chargeoffs over 180 days? That caused us to accelerate a fair amount of charges in there. So we think there's a – if you will, almost a one time blip in there, although we'll know more in the next quarter about how much that's one time or not.

Operator: And our next question comes from Brian Bedell from Merrill Lynch. Please go ahead.

<Q – Brian Bedell>: Hi, good afternoon, guys. If you could just -- can you hear me?

<A – Donald Layton>: Yes.

<Q – Brian Bedell>: That's great, okay. Can we just go back to the range, the 1 to 1.5 billion on the home equity portfolio? You went over the economic assumptions but if you could also talk about what unemployment rate you're assuming and to what degree that -- what 1.5 could expand, say with a much higher unemployment rate, like say, 8%?

<A – Donald Layton>: The modeling we used does not, if you will, go way back to something fundamental -- unemployment rate causing people to be delinquent and such. Instead, we are looking at the directly measurable thing of how the roll rates in our portfolio are doing. Those roll rates have been poorer as we've gone through the year reflecting the economy, therefore how people pay, how much more likely they are to cure their delinquency or not. And so we're going more directly to that and so there isn't a direct connection to an unemployment assumption. It is, if you will, delinquency patterns. And how much could it change? The answer is, as I said, one must be humble in this environment. If housing prices do more poorly than Case-Schiller has, if the economy gets worse such that roll rates would deteriorate, we could move above the 1.5 billion range.

<Q – Brian Bedell>: Okay and then as a follow up, if the economy were to deteriorate and you were projecting higher losses, what other asset sales would you consider? For example, would the other international brokerage business be interesting?

<A – Donald Layton>: No, actually, right now, when you combine all our notions of what we need to do, salability, what's core, what we think has growth potential in the future, what people will pay us for an asset versus what we earn on it, we think we're pretty much done. There's one small other item in the pipeline. I'm not going to disclose it, but it's small so it's not material to this conversation. We think between again, the bank's earnings pre-provision, we think between the excess capital of the bank, the cash coming in later this year at the parent, that we have a very substantial cushion against our current forecast.

Operator: And our next question comes from Bruce Wilcox from Cumberland Associates. Please go ahead.

<Q – Bruce Wilcox>: Hi, good afternoon, thanks for taking the call. I'm kind of curious, with the prospect of collecting about, what, \$660 million in cash from the two major asset sales, how you're -- and also your expectation for the bank earnings, whether your appetite for the debt equity swaps may be somewhat diminished. And just kind of how you think about that, whether you think about that on an appraised value, or on an earnings basis, or none of the above?

<A – Donald Layton>: I'd say the parent -- I'd say for the long run health of the company, both bottom line and leverage, we need to have a plan to reduce the debt and debt service charges at the parent of a very substantial amount. So, I can see the debt for equity swaps especially on the existing high yield debt continuing for some time, so unabated appetite to continue at the rate we're doing it now, even though we will have this cash cushion at the parent, and even if, at the end, the parent, the cash cushion could largely be used for debt repayment, I'd say we would be interested in doing that extensive debt repayment over time.

<Q – Bruce Wilcox>: And then just as a follow up, did I hear correctly that the expected corporate interest level, quarterly run rate going into 2009 is about 45 million?

<A – Donald Layton>: No. You heard that the corporate interest expense run rate going into 2009 would be about 50 million less than it started 2008 at, Bruce. Okay? It's currently, it's about -- per

annum, run rate. I believe the beginning of the year number was about \$360 million, so it would be down to close to the 300 million level and I would like it to be lower in the succeeding years.

Operator: And our next question comes from Mike Carrier from UBS. Please go ahead.

<A – Donald Layton>: Mike?

Operator: Mr. Carrier, your line is live.

<A – Donald Layton>: I guess, operator, we'll move to the next person.

Operator: Our next question comes from [inaudible]. Please go ahead.

<Q>: Hi, good evening, guys, how are you?

<A – Donald Layton>: Okay.

<Q>: I think I may have missed this. Have you received the cash from the tax refund and if so is it a Q2 or a Q3 event?

<A – Donald Layton>: We have received the cash from the IRS. It was a Q --

<A – Matthew Audette>: It was a Q2 event, and it was due primarily to the bank so it did not impact the corporate cash levels.

<Q>: It was just a balance sheet in fact down at the bank level?

<A – Matthew Audette>: Right.

<A – Donald Layton>: Right.

<Q>: And with respect to your statement you made on 6/30 that by year end you will approach \$1 billion of excess capital, does that include any of the asset sales, cash proceeds being downstream? I'm just trying to bridge that number with the 700 to \$800 million.

<A – Donald Layton>: No. We talked earlier about the bank approaching 1 billion of excess risk based capital. We are revising that to the 700 to 800 million to reflect mainly the fact that we have the Fannie and Freddie loss which we did not. And also, of course, credit losses being slightly higher.

<Q>: And when you look at the sale, the E\*TRADE Canada asset, I think they had disclosed it was about roughly 125,000 accounts. So that's a pretty significant valuation at roughly, what, 3500 an account and at 25 times PE multiple for those numbers, sound about right?

<A – Donald Layton>: The answer is yes, and we would agree it's a very high valuation for the business.

Operator: That concludes the time allotted for questions. I will now turn the call over to Don Layton for closing remarks.

**Donald H. Layton, Chairman and Chief Executive Officer**

Thank you. I guess in my own words, I think there are three big take aways from all this press release and all the information we've given you. One, concerns about the core retail customer

business being damaged by the credit crisis last year clearly are not true. That business is fully competitive, gaining profitability, growing, gaining customers, and performing fine. The franchise is back, and it's strong.

Second, the not so good news is credit losses are higher than we had expected. This should be a surprise to no one, given that what's going on in the economy and housing markets are clearly worse than predicted all around.

However, point number three, is that the execution of our capital plan and the turnaround plan has been so successful, so robust, we think we are very well positioned to absorb those higher losses and any kind of other reasonable shocks people can assume over the next period of time, leaving us in a position to return to profitability as those losses pass through with our core business generating that profitability and serving our clients. On that note, thank you, everyone.

Operator: Thank you, everyone. This does conclude today's conference call. You may disconnect your lines at this time, and please, have a wonderful day.

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