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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the E*TRADE financial Fourth Quarter and Full Year 2010 Earnings Conference Call. [Operator Instructions]

Thank you. It is now my pleasure to turn the floor over to Susan Hickey from E*TRADE Financial. Please go ahead.

Susan Hickey, Financial Media Relations

Good afternoon and thank you for joining us for E*TRADE Financial's fourth quarter and full year 2010 conference call. Joining me today are Steven Freiberg, E*TRADE's Chief Executive Officer; Matt Audette, our Chief Financial Officer; and other members of E*TRADE's management team.

Before turning the call over to Steve, I'd like to remind everyone that during this conference call, the Company will be sharing with you certain projections or 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-K's, 10-Q's, and other documents E*TRADE files 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 January 26, 2011. Please note that E*TRADE Financial disclaims any duty to update any forward-looking statements made in the presentation. During 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 investor.etrade.com. This call is being recorded and a replay of this call will be available via phone and webcast beginning this evening at approximately 7 PM. The call is being webcast live at investor.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

And with that, I will turn the call over to Steve Freiberg.

Steven J. Freiberg, Chief Executive Officer

Thank you, everyone, for joining us this afternoon. To begin today's call, I will cover the highlights for the quarter and year, and Matt will take you through the results. From there, I will share some thoughts about 2011, after which, we will be happy to take your questions. 2010 was a significant year for E*TRADE, as we made important progress to position the Company for sustainable profitability and growth. While we navigated the challenges of an industry-wide decline in trading activity and a difficult interest rate environment, we also benefited from solid execution in our retail brokerage franchise, a strength in capital structure, and improving trends in our legacy loan portfolio.

Overall, we made marked progress and improved from a loss of $1.3 billion in 2009 to a loss of $28 million in 2010. Our fourth-quarter performance was quite strong, notwithstanding several expenses that we do not expect to incur in future periods, as well as an increased advertising spend. Matt will provide additional color later in the call, but let me take just a moment up front as well.

These expenses included a $60 million increase to the qualitative component of our loan loss reserve. While we continue to be pleased with the progress of our legacy loan portfolio, in particular, trends in delinquencies and our loan modification program, this increase reflects the growing size and importance of our loan modification program, as well as the limited historical information or industry knowledge of how these modified loans will perform over the cycle.

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On the expense side, we incurred approximately 15 million of expenses related primarily to restructuring and severance, which will drive future savings. At the same time, our increased advertising spend is driving meaningful results, and supports our strategy to attract and retain customers and increase brokerage inflows. We are optimistic that this spend will help continue the momentum we enjoyed in the fourth quarter, which included our highest brokerage and stock plan account growth and net new assets flows since mid-2009.

Turning back now to the year, we entered 2010 with a solid brokerage business and improving trends in our loan portfolio, supported by a successful recapitalization. Over the course of the year, we delivered growth in net new accounts, net new assets, and margin receivables. Improving loan performance trends drove a significant decline in our loan loss provision. And effective balance sheet strategies resulted in solid net interest income, while we benefited from opportunistic gains in our securities portfolio.

During the year, we executed on a number of initiatives to expand our offering and enhance the customer experience for both active traders and long-term investors. And I'll highlight a few. E*TRADE capital management launched managed investment portfolios with a competitive fee structure and an accessible entry point of $25,000. E*TRADE securities simplified its pricing structure and we believe is competitively positioned from a price value perspective.

We released API, allowing third-party vendors and independent software developers to interface seamlessly with our investing platform. We expanded Power E*TRADE Pro's customization, news and information, and navigation tools, and added CNBC's streaming video. We extended our leadership in the mobile space by adding E*TRADE Mobile Pro for iPad, Android, and Blackberry Storm, and now see approximately 100,000 unique customers logging in via our mobile applications each week.

We delivered investor education through more than 630,000 interactions, via both live and online events. And our Corporate Services Group launched Equity Edge Online, an award-winning platform for stock management and reporting. To support and complement these initiatives, we recently kicked off our 2011 integrated marketing campaign with spots that build on the investing unleashed tagline.

This campaign highlights the value and service available to E*TRADE customers, in particular those with long-term investing goals. And as we have in the past, we will unveil two new E*TRADE Baby spots in conjunction with the upcoming Super Bowl. We believe the Super Bowl provides a unique opportunity to efficiently reach approximately 100 million people, and creates a springboard for significant online and offline interaction with customers and prospects.

In combination, these product and service enhancements were instrumental in driving organic growth in accounts and inflows, and are reflected in the improvement in our annualized brokerage account attrition rate from 14.3% in the fourth quarter of 2009 to 10.3% in the fourth quarter of 2010. This progress is consistent with our goal to continually improve our franchise and attrition rate.

Before turning the call over to Matt, I'd like to add a few words about our senior management team. First, as we announced in December, Bruce Nolop retired as CFO at year-end. We are grateful to Bruce for his contributions to E*TRADE and wish him the very best. I am delighted that the depth of our team allowed for such a smooth transition and pleased to have Matt as our CFO. I have worked closely with him over the past nine months, and I know that his leadership skills and company and industry knowledge will serve us well.

We have made two additional executive appointments that will support us as we pursue accelerated growth. First, Amy Radin joined as Chief Innovation Officer to lead initiatives that extend our current offerings through disruptive innovations. She will complement the innovation

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work already in place, with an initial focus on identifying growth opportunities in the long-term investor space. Amy has extensive experience via leadership roles at Citi and American Express. Second, we welcomed Andy Goodman as Chief Human Resources Officer. Andy will lead our efforts to ensure that our organization aligns with our growth plans, while we attract and retain industry's top talent.

Previously, Andy led HR at CA Technology, and has held senior roles with both Merrill and Bankers Trust. We are pleased to have Matt, Amy, and Andy join E*TRADE's executive team, which already includes an impressive roster of industry and company veterans. I believe we have the right team in place to drive our growth strategy and create shareholder value.

From here, I'll turn the call over to Matt.

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

Thank you, Steve. During the quarter, we had a net loss of $24 million or $0.11 per share compared with a net loss of $67 million or $0.36 per share a year ago. For the full year, we reported a net loss of $28 million or $0.13 per share, which compares quite favorably with 2009's net loss of $1.3 billion or $11.85 per share. Our full year 2009 results included a $773 million non-cash charge related to the debt exchange. Excluding this charge, our net loss for 2009 would have been $525 million, or $4.79 per share. As Steve indicated, our quarterly and full year results included an increase at a qualitative component of our loan loss reserve of approximately $60 million, without which the comparisons would have been even more favorable.

During the quarter, we generated $518 million of net revenue, up 6% from $489 million in the third quarter, and down just slightly from $523 million reported in the same quarter a year ago. For the full year, net revenue was down 6% from $2.2 billion to $2.1 billion, a decline driven primarily by changes in our fee structure and lower trading activity as experienced across the industry. Our fourth quarter revenue included net interest income of $305 million, up $6 million from last quarter. This reflected a net interest spread of 2.88% on average interest earning assets of $41.5 million.

Commissions, fees and service charges, principal transactions and other revenue in the fourth quarter were $181 million. This was a 20% increase compared to the third quarter, and reflected growth in DARTs during the period, as well as a $0.34 increase in average commission per trade, resulting from a more favorable customer mix. For the full year, while we experienced a 17% decline in these line items due to lower DARTs and pricing actions taken during the first half of 2010, we were pleased to report only a slight decrease in average commission per trade, from $11.33 to $11.21, as our customer mix evolves to reflect a diverse group of active traders, long-term investors, and corporate services customers. Our revenue this quarter also included $32 million of net gains on loans and securities, including a net impairment of 10 million, as we managed our investment portfolio to limit our risk and realized gains due to favorable market opportunities.

Our total operating expenses for the year declined 8%, or $101 million from the prior year. And while our expenses during the fourth quarter of 2010 declined by $14 million or 4% compared with the fourth quarter of 2009, we did report a 14% or $38 million sequential quarterly increase in expenses. This increase was driven primarily by several expenses we do not expect to incur in future quarters, as well as an increased advertising spend. Specifically, we reported $10 million in restructuring expenses, including the final stages of our international business restructuring, which creates future savings. We also recorded approximately $5 million in compensation expenses related primarily to severance payments.

In addition, while our professional services expenses were up slightly in the fourth quarter, we note last quarter that our results reflected a $6 million credit and this was not repeated in the fourth

quarter. Going forward, we expect professional services expenses to return to a run rate consistent with our level of expenses in the first half of 2010. We also had a $13 million seasonal increase in advertising spend, which supports our strategy to attract new accounts and assets. Steve will comment further when he shares our outlook, but I want to emphasize here that we expect our expenses before strategic investments to decline over time, that we expect to reinvest a majority of the savings into initiatives that we expect to drive profitable growth.

Turning now to the metrics, DARTs for the fourth quarter were 151,000, up 19% over last quarter and down 5% from a year ago. For the full year, DARTs were down 16% from 179,000 in 2009 to 151,000 in 2010, with 2009 marking a particularly active year for retail investors, followed by the industry-wide slowdown that began in May 2010. While trading activity was not as robust as we have experienced in recent years, we were pleased with the strength in a number of customer metrics.

During the fourth quarter, gross new brokerage accounts were up 13% year-over-year, and net new brokerage accounts were 28,000, our highest level of net new accounts since the second quarter of 2009, a period of significant account growth. In total, we added 54,000 net new brokerage accounts during the year. Net new brokerage assets, an important measure of account quality, also grew nicely during the quarter and year.

We added $2.4 billion during the quarter and a total of $8.1 billion during the year. This represents the highest quarterly inflows in two years and an annual increase of 13% compared with 2009 results. Brokerage customer cash increased by $1.9 billion to $24.5 billion, while bank customer cash declined by $300 million.

In total, we experienced a net increase of $1.6 billion of customer cash deposits, which helped offset the seven basis point contraction in net interest spread. Margin loans to customers also grew over the course of the year, with average margin receivables growing during the fourth quarter by 4%, compared with the third quarter, and up 40% compared to the same quarter in 2009.

We continue to be pleased with the progress of our legacy loan portfolio and with the success of our loss mitigation activities. The portfolio contracted by approximately $1 billion during the quarter. Net charge-offs declined for the sixth consecutive quarter and delinquency trends continued to be favorable, exceeding our expectations in the fourth quarter. Special mention, home equity delinquencies, as an example, are at their lowest levels since the first half of 2007.

We expect these trends to continue, although performance is subject to variability in any given quarter. Despite this positive outlook, we increased the qualitative component of our general allowance for loan losses from 5% to 15%, which caused the provision to rise by approximately $60 million in the fourth quarter. As a reminder, our allowance for loan losses is composed of three distinct elements, first, an allowance for loans that have not been modified, which is equal to our loss expectation over the next four quarters for those loans; second, an allowance for modified loans, which is equal to the life of loan loss expectation plus the economic concession granted for the modified loans.

And finally, a qualitative component, which is meant to account for a variety of economic and operational factors that may impact our level of credit losses, but are not specifically considered in our loss model. The decision to raise the qualitative component primarily reflects the growing size and importance of our loan modification programs. To date, we have modified more than 1.3 billion of one-to-four family in home equity loans and the allowance for modified loans accounts for 35% of the total allowance.

We continue to be pleased with the success of these programs and believe they will achieve a meaningful reduction of losses, while allowing borrowers to remain in their homes. However, there is limited historical information or industry knowledge of how these modified loans will perform over

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the long-term. Given this combination of a higher concentration of modified loans and limited historical information, we thought it was appropriate to increase the qualitative component of the general allowance.

Loan charge-offs declined from $222 million in the third quarter to $195 million in the fourth quarter. And we were down from $1.4 billion in 2009 to $931 million in 2010. Accounting for seasonal factors, fourth quarter portfolio performance was better than expected. Our home equity portfolio special mention delinquencies decreased 13% to $175 million, the lowest level since the first half of 2007.

In our one-to-four family portfolio, we did experience a 3% increase in special mention delinquencies, but this was better than the anticipated seasonal impact. The allowance for loan losses at year-end was $1 billion, essentially flat compared with the prior quarter, and it remains at 6% of gross loans receivable.

We were pleased that the bank generated $202 million of regulatory risk-based capital and $234 million of Tier 1 capital in 2010. As of December 31, the Tier 1 capital ratio at the bank was 7.29% to total adjusted assets and 13.71% to risk weighted assets. We ended the quarter with $1.1 billion of risk-based total capital in excess at the level that our regulators defined as well-capitalized.

On a consolidated basis, we ended the year with $1.5 billion in Tier 1 capital, an increase of more than $400 million compared to year-end 2009. While we are not currently subject to minimum capital requirements on a consolidated basis as a savings and loan holding company, provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act will impose these requirements within the next five years.

Therefore, we have begun to track these ratios internally on a pro forma basis as we plan for this future requirement. As of December 31, the consolidated Tier 1 capital ratio was just above 3.5% to total adjusted assets and just under 7% to risk weighted assets. We anticipate that we will be above all well capitalized requirements on a consolidated basis, well in advance of the effective date, and do not have any plans to raise additional capital as a result of these requirements. We ended the year with $471 million in corporate cash, up from $393 million at the end of 2009.

In summary, we were very pleased with our quarterly and full-year performance, and believe it positions E*TRADE well for 2011 and beyond.

With that, I will turn the call back to Steve for additional remarks.

Steven J. Freiberg, Chief Executive Officer

Thank you, Matt. Before opening the call for questions, I would like to share our plans and outlook for 2011. We entered the New Year with strong momentum and increased flexibility to aggressively address four growth areas that we believe will enhance shareholder value in 2011 and beyond. These will be our areas of focus for the year.

First, we will leverage our successful brokerage franchise by growing our sales resources, expanding our product and service offerings, and maximizing our advertising spend. This includes a planned 35% increase in sales professionals, increasing our emphasis on long-term investor and retirement offerings, including managed investment portfolios and the Unified Managed Account product launched earlier this month. The product road map also includes further development and enhancements in the mobile, personalization, API, and community areas.

Second, we will build on our corporate services and capital markets groups. Related to corporate services, we will address large client, C-suite and partnership opportunities, and have – in fact,

have plans to double our sales force to call on C-suite prospects. Through our market-making business, we are focused on maximizing the benefit of internal order flow, while increasing external order flow. Third, we will identify and test disruptive innovations with the potential to deliver value propositions that redefine the customer experience for self-directed investors seeking enhanced ways to manage their wealth.

And finally, we believe that our bank can continue to play an important role in helping us optimize the value of our stable and low-cost brokerage customer deposit base, which continues to exhibit solid growth. As it relates to our 2011 outlook for business performance, we are cautiously optimistic that the individual investor engagement will build on what we experienced in the fourth quarter, and drive 2011 customer activity levels above 2010 levels. And though it is still very early, we have enjoyed a reasonably strong start, with January DARTs up 23% over December.

We continue to target a net interest spread of 300 basis points, though the current environment of extremely low interest rates makes this target challenging in the near term. We expect continued improvement in loan portfolio delinquency trends through 2011, although at a less pronounced rate than we experienced in 2010. The improvement is due primarily to the continued decline in the absolute size of the portfolio, continued risk mitigation initiatives, and the overall credit quality of the remaining loans. We also expect that the loan loss provision will continue to decline, though at a slower pace, as the overall portfolio declines.

We will continue to focus on expense management and expect overall operating expenses to decline slightly in 2011. While we plan to increase our investment in sales and advertising, we expect that this will be more than offset by a decrease in servicing costs tied to the reduction in the loan book, productivity related savings, and lower restructuring charges, as our international restructuring was completed in 2010. Finally, we expect to be profitable for the full year in 2011. So it has been a meaningful and busy year. We are proud of our progress and look forward to building on our momentum in 2011 and beyond.

With that, Operator, we are ready to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Daniel Harris of Goldman Sachs.

<Q – Daniel Harris>: Hey, guys. How you doing?

<A – Steven Freiberg>: Good, Dan.

<Q – Daniel Harris>: Steve, one of the things you guys have been focused on is also growing that margin loan portfolio. And it looks like that did tick up here in the quarter. I was wondering if you could help us think about how you see that continuing to progress throughout the year. Obviously, that's at a nice high rate and that could offset some of the NIM pressure that you're seeing in the rest of your business.

<A – Steven Freiberg>: Yeah. I mean, clearly, it's one of the priorities that we do have within the business. And typically, as you're more than aware, it is a function of net buying. And clearly, we've seen a pick-up both in net buying as well as in the margin loan portfolio itself. And we expect that will continue. But we can't really give you precision, but in line with what we've seen in January with the DARTs, I would say the margin loan portfolio continues to move in the right direction. So we're encouraged.

In addition to that, we expect to increase some product capability in this area as well in the early part of 2011. And I would strongly agree with the commentary that we see this as a strategic imperative to maintain the yields on our books in a way that is both strategically important as well as low risk, particularly credit risk. And we think we have very good controls on the operational side of margin.

So we were very satisfied in 2010 with the growth. And we do have aggressive plans for 2011, both to grow the portfolio as well as basically expand product. And finally, if we can – and we hope we can, we believe we can – maintain the momentum that we have in adding net new customers and keeping those that we have, that just increases the size of our overall franchise and, clearly, margin is a derivative of that as well.

<Q – Daniel Harris>: Okay, great. Thank you.

<A – Steven Freiberg>: Okay.

<Q – Daniel Harris>: And then I'll just ask one more and hop back in the queue. So the way we should be thinking about the provision here going forward, the $60 million one-time, so if we were to strike that and say, it would have been roughly 134 this quarter, I guess two questions for maybe Matt. One, is that the right way to think about it, that sort of 134 run rate, is the – is sort of how it would have been this quarter, all else equal, and then that's what we should use going forward? And then, two, I'm a little surprised, given the tick-up in first liens that it would have been excluding that one-time, lower by $18 million from last quarter. I was wondering if you could help us, comment on that. Thanks a lot.

<A – Matthew Audette>: Sure. So, with the $60 million, the short answer is yes. Without that, it would have been $134 million for the quarter. As far as going forward, I think we would reiterate our long-term view that provision will decline over time. But in any given quarter, there could certainly be volatility and variability. So a long-term trend, yes; each individual quarter, not necessarily.

Specific to the delinquencies and do the delinquency numbers for the quarter make sense for $134 million. I think the short answer is both one-to-four family as well as the home equity delinquencies were quite favorable for the quarter. Specific to one-to-four, it was up quarter-over-quarter. But if you see for the monthly metrics that were released in November, it was done nicely in December.

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So some good trends there, although you can see it could be volatile, which is why we think each individual quarter could be volatile, but long-term trends look good.

<A – Steven Freiberg>: Just to add, Dan, my perspective. We were quite – we were pleasantly satisfied with the delinquency trends in the fourth quarter. Just to remind the group, in our models and basically in the historical record experience, fourth quarter tends to be a seasonal period where we see essentially delinquencies expand, and for a whole host of reasons in the fourth quarter we did not experience the seasonality that we had expected and that also helped shape, essentially, our outlook as well. Although notwithstanding, Matt's commentary is correct on several fronts. Volatility or variability remains, but the direction and the trend I think is quite distinct and should continue. And finally we do basically, we depict and we expect the qualitative increase to be of a non-recurring addition. And you can basically subtract the 60 from the 194 to get what I would say would have been the baseline or the model-based expectation for provision.

<Q – Daniel Harris>: Okay guys. Thank you.

Operator: Your next question comes from Matthew Snowling of FBR Capital Markets.

<Q – Matthew Snowling>: Yeah, hi. Good evening. I'm just wondering, just going back on the issue about the provision. It looks like you'd been releasing a little bit of reserves over last few quarters and I'm just wondering – I'm still not clear as to what changed in terms of your thinking that you had to go back and kind of build back that reserve?

<A – Steven Freiberg>: Yeah, this is Steve. Let me just spend a moment on that. Because clearly the delinquency trends and the coincident increase on the qualitative provision do, I think require the right level of discussion. Nothing has changed from the standpoint in our models and nothing has really changed from the standpoint of what we see from performance.

What we relied upon is that over the course of, I'd say the last 18 months or so, modifications as a percentage of our overall reserves have increased substantially and that's consciously. This is not a surprise to us. But that said – and this is an industry as well as I believe an E*TRADE commentary – what we don't have is a body of experience over the full cycle as to how modifications will actually ultimately play out. So to this point, they're actually tracking at or better than our models.

So our level of confidence is reasonably high, but at the same time we have to acknowledge that there is a degree of uncertainty that's related to this particular issue as well as the broader macro economic environment in which we're operating. And with that in mind, we thought it was reasonable to increase the qualitative component of our reserve at this point and we have. And obviously that's been roughly the $60 million. And just to give full context, the 60 needs to be put in the context of the full qualitative reserve, which now stands at just short of $90 million.

We historically, the last I would say 12 to 15 months, have carried about a qualitative reserve that would be equal to about 5% of our FAS 5 reserve. We now have increased that to 15 and on the items that I've cited. But again you have to put it in that perspective in order to understand how we derived it.

<Q – Matthew Snowling>: Okay. Can I ask then going forward, should we expect the provision to run lower than charge-offs?

<A – Matthew Audette>: Matt, this is Matt. I think that – the same comment to the prior question. I think over the long term absolutely yes. But there could be variability in individual quarters, but over the long-term, I think that's the correct view.

<A – Steven Freiberg>: Yeah given the delinquency trends and the decreasing size of the portfolio and our perspective view fully endorsed clearly that commentary. That is the expectation, again

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always putting in the caution that there's variability or volatility. But I think it's hard to deny the overall trend that's been established, notwithstanding the non- – expectation of the non-recurring event that we deployed this quarter.

<Q – Matthew Snowling>: Okay, understood. Can I sneak one more in here on the agreement, the order flow agreement with Citadel? Can you help us kind of understand or remind us what the revenue impact would – of that will be?

<A – Steven Freiberg>: I can't quantify it for you, but I can put it in perspective for you and for the group that's listening in. And I think most folks are familiar that our contractual agreement with Citadel expired at the end of 2010. So at this point, we are working to optimize or maximize the value of that flow. Some of that will incorporate internally. Some of that we'll basically parse externally and without quantifying it into sort of an economic benefit, what I will tell you is that our market making business continues to exhibit very good top line and bottom line growth.

And I'd just end the commentary that our relationship – our business relationship with Citadel has been terrific. We still do a substantial amount of business with them in this area and we have a good relationship that we should sustain over a lengthy period of time. And so that said, it gives us more degrees of freedom, but the relationship that we've had I think was mutually beneficial over the period and will continue.

<Q – Matthew Snowling>: Thanks.

Operator: Next question comes from Rich Repetto of Sandler O'Neill.

<Q – Richard Repetto>: Yeah. Good evening, guys.

<A – Steven Freiberg>: Good evening, Rich.

<Q – Richard Repetto>: Yeah. I guess – first congrats on a strong brokerage quarter. The metrics were definitely strong and in line with your peers or better. But the question here is on this qualitative adjustment to the allowance. If I understand if I'm – from your explanation, what you're doing is you've modeled out the mod portfolio. You have expected losses, but then you don't have the degree of confidence because there isn't a history that the model will work, so you set aside a special amount in an incremental 60, now 90 million. I guess the question is why should there be confidence that that 90 million is enough if you've acknowledged that you just don't know what this portfolio is going to do?

<A – Steven Freiberg>: Yeah. I think largely you've articulated it well from the standpoint of the logic that we followed. But we can say and emphasize, we do have – we don't have the full cycle of experience with it, but the experience that we have to date, which is significant, is proving out that it is tracking basically to the models that we've developed, the expectations that we hold and so we have a level of confidence that through this part of this cycle, which has been a very stressful cycle nonetheless, it has performed within or better than expectations.

But at the same time, we don't fully understand, nor do we think anybody fully understands what the full cycle implications are. And in addition to that, we know that the macro economic environment is still tenuous and we thought it was reasonable then to build this component into our current reserves.

It could be substantially better than what we're carrying. Could it be higher? The answer is, it is possible, but the evidence that we have to date is showing for the mods in particular, they are tracking well to the models we've built and our expectations. And so when we basically sat back and thought about it, it had nothing to do with the actual performance. It had much more to do with taking a stance and an acknowledgement that we're still in an area that has uncertainty.

We hope that we're accurate and therefore this qualitative reserve will accrete back with time. But we can't basically say with certainty that we think we've taken a reasonable position relative to the prospective risk that may be out there – but I'll emphasize may – and so understanding that it has somewhat of a lack of congruency with the delinquency trends that you've seen in the same quarter. But this is what we believe to be a reasonable approach. And I'll just emphasize we do not expect this to recur.

<Q – Richard Repetto>: Okay. One last question on this now, but is this driven by an auditor? Because it looks like from your optimism about the general business and it certainly looks like the macro environment is generally – I'm not saying improving greatly, but slow improvement that – I'm just interested in what drove this, if it is performing at your models now and why would you increase – that's what I still don't – I don't fully get.

<A – Matthew Audette>: Yeah. Hey, Rich it's Matt. I think that the short answer is it's exactly what Steve said. And to his point, it might – doesn't necessarily match up with the data that you're seeing. But at a high level, it's a matter of judgment for the very uncertainty that he highlighted. It's not a – not a thing that we would comment on auditors or anything else like that. It's a judgment item in an area that has uncertainty associated with it.

<Q – Richard Repetto>: Okay. And moving onto the – just one other quick – it's not quick, but some of things that investors are watching in the development or the evolvement of the model like upstreaming of the capital, potentially bringing down wholesale funding, or as you talked about last quarter, the segmentation and potentially doing loans to well qualified clients, where are we in that? Any progress after an additional quarter on any one of those fronts?

<A – Matthew Audette>: So I'll take the first two. So on upstreaming capital, Rich, I think that we've $1.1 billion of excess capital or risk based capital in the bank. You could guess it certainly would be our preference at some point to upstream that to the parent. I think you'd also know that to do that, we would need regulatory approval. And we can't speculate on whether we would – when and if we would get that approval. So it certainly would be our preference, but it's a regulatory matter.

For the wholesale book, I think over the long-term, that would eventually come down and be replaced by customer deposits. But as we've talked about a few quarters in the past, that would not happen in the near term, more of a long-term item.

<Q – Richard Repetto>: Okay. And the customer segmentation, is that a – more of a long-term thing I assume as well?

<A – Steven Freiberg>: Yeah, I mean clearly, we've talk about it, and we'd expect to do testing and learning before it would be anything of material impact to the business, so that I wouldn't describe it as a 2011 event about that.

<Q – Richard Repetto>: Okay. Thank you very much, guys.

Operator: Next question comes from Eric Bertrand of Barclays Capital.

<Q – Eric Bertrand>: Following up yet again on the qualitative portion, I'll ask it a little bit differently. Are there any inputs to that qualitative or any other allowance for loan loss that are more macro-based i.e. management's assumptions of the path of the unemployment rate or the broader capital and credit conditions of the U.S.?

<A – Steven Freiberg>: No, those have actually remained either consistent, both for the macroeconomic outlook and in addition to that, for things like home price depreciation. Those variables have actually stayed aligned, no significant variation.

So it wasn't either model or model input driven, if you're trying to look at whether or not there's a data set that has caused a change. I think you have to go back to what both Matt and I have said. It has much more to do with a broad-based qualitative view of uncertainty without specificity of any particular set of events today. So, and that's just the nature of judgment on the qualitative component of this. And I know you're looking for – I know you're trying to find either specificity – if we had specificity, it would not have manifested itself then in this – in essentially the qualitative reserve.

<Q – Eric Bertrand>: Fair enough. Shifting gears to again the capital requirements and that sort of thing, with the benefit of an additional quarter's proximity to the implementation of Dodd-Frank and Basel III better part of a decade from now, could you comment on some of the implications on your capital structure and any sort of estimate as to what you think your Basel III risk weighted assets would be?

<A – Matthew Audette>: Sure, Eric. It's Matt. So starting off with Basel III, we're certainly focused on reviewing the Basel III final framework, a little bit uncertain to us how the U.S. regulators would eventually adopt that framework. But given the framework as it stands, we've begun similar to the holding company capital ratios under Dodd-Frank to do internal pro forma analysis as we move towards that implementation date. So the nearest implementation date's in 2013. We would meet those capital requirements today specific to the Tier 1 capital ratio and fully expect over time as they increase all the way through 2019, we would expect to meet them over that time as well.

Now specific to Dodd-Frank, the holding company capital ratios under the FED guidelines, we would expect those requirements to be implemented within the next five years. And we – while we do not meet the Tier 1 capital ratios today, we would expect within the next two years or so to meet those requirements. So we think we are well on our way on Dodd-Frank and are well on our way on Basel III as well, not a big issue of concern for us.

<Q – Eric Bertrand>: You were very specific about Tier 1 capital. Would you agree – would you make the same comments if it was Tier 1 common?

<A – Matthew Audette>: Yes I would. So the most stringent ratio is a Tier 1 common in 2013 at 3.5%, moving up to the final 7% in 2019. Yes I would.

<Q – Eric Bertrand>: Okay. Thank you.

Operator: Our next question comes from Howard Chen of Credit Suisse.

<Q – Howard Chen>: Hi, good evening, Steve. Hi, Matt.

<A – Steven Freiberg>: Hi, Howard.

<Q – Howard Chen>: Just stepping back on the credit quality outlook, could you just update us on your assumptions for home prices in 2011, maybe a sensitivity to every 1% move in home prices and how many new mods you're anticipating from that 1.3 billion level?

<A – Steven Freiberg>: Sure, I would just – I'm going to ask Paul Brandow, who's the Senior Credit Officer, to kind of give you perspective on what we can provide.

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<A – Paul Brandow>: Right. And then I'll ask Bob Burton to talk about the modifications, but in terms of the inputs to the model, we are using a – in terms of housing prices – a 4.6% decline over the next 12 months during the course of 2011 that is.

<A – Robert Burton>: In terms of modifications, we did a little over 700 million in modifications this year. We would expect that number to decline slightly as the portfolio runs off next year, but we'll continue to be aggressive with the program.

<Q – Howard Chen>: Okay. And then just to – so, at that level of mods, you think just with the provisioning level, it can be more of a rebalancing of the current provision, rather than a release or incremental build?

<A – Matthew Audette>: Howard, this is Matt. I would say that the comments we made on provision over the long term of provision coming down over the long-term and charge-offs as well, I think the comments are just the same. On modifications, the modification activity would not impact that at all other than again the variability there and volatility that could occur in an individual quarter.

<Q – Howard Chen>: Great. Thanks. And then shifting gears to this net interest margin, Steve, I fully appreciate your commentary on the challenge of near-zero short rates. But just given what's happened with the shape of the yield curve a little further out and the balance sheet mix shift, you spoke to higher margin utilization. Shouldn't that be supportive – more supportive of you being able to get to that 3% and maintaining that faster and longer?

<A – Steven Freiberg>: Yeah, I think directionally the answer is yes. If you looked at the fourth quarter results, we came down a bit. I think we were at 288 in the quarter, so we had dropped about seven basis points I believe or so. And the offset to that was clearly, we benefited from having a larger balance sheet, driven entirely by our customers keeping more of their cash within our bank which was quite helpful. We've kind of – we've said this before. We think the model long term is 300. We'll vary from that in this particular area. Although the last, I would say, three-four months has been actually quite helpful to get us more confident, not so much on the 300, but the 288 that we basically realized in the fourth quarter. I wouldn't call that an absolute into 2011, but I would say that we're in the ballpark from the standpoint of kind of maintaining reasonable spreads even though we would still categorize this as a very challenging environment.

And over time, we think the 300 is in fact attainable as a model, a long-term view of the value of these deposits. And we're working within the constraints of today's market with an expectation over some reasonable period of time, we'll pierce – or we'll basically realize the model. I just can't go on record, because I can't predict precisely the environment, how close or how far from that 300 we'll come into 2011.

But I know even for the last several quarters there was a lot of concern, and I think we've maintained ourselves at a reasonably high level by doing a number of things not so much impacting the duration of our portfolio, but being smarter about how we utilized cash and being smarter about essentially how we invest our money. And so we feel reasonably good, but I wouldn't mind seeing a steeper curve and absolutely higher rates, although, it sounds it little bit un-American.

<Q – Howard Chen>: No. Understood. Just a quick follow-up to that then, which is appetite for any sort of opportunistic expansion on a piece of the portfolio?

<A – Steven Freiberg>: I won't comment on that, but I will say that we're always evaluating opportunities and we do basically take both a strategic as well as a tactical view. And I would expect that over the course of 2011, there will be tactical opportunities.

<Q – Howard Chen>: Okay. Thanks very much for taking the questions.

Operator: Your next question comes from Mike Vinciquerra of BMO Capital Markets.

<Q – Michael Vinciquerra>: Thank you. Just a follow up there on the balance sheet, were you surprised at all with that – it's the first quarter in a while you've had any balance sheet growth in terms of interest earning assets, obviously strong flows into the cash side. Is it telling us anything about what clients are doing with their – do they still seem to be relatively risk adverse or is that starting to change here in the New Year given that, the bump you've seen in DARTs?

<A – Steven Freiberg>: It's a fair question, and I will say that we were pleasantly surprised by the absolute level of cash inflows. Several things have basically worked in our favor without really addressing possibly the psychology of the retail customer. I think first, we focused for the last I would say 12 to 18 months on the quality of our customer base and the customers that we have today more often are holding absolutely higher balances, regardless of the market volatility. And then the percentage of cash that they hold in relation to that in absolute dollars has really been beneficial to us. So one, having more customers and better quality customers really has played to our advantage.

That said, it clearly doesn't fully explain the $1.6 billion that did flow in during the course of the fourth quarter of 2010. But again, and I don't have a good answer on what the customer's actually thinking there, but what I will tell you is that we are seeing that – we have seen that buying in the recent point.

The dynamics seem to be working the way they should, that when we have more net buying, we see cash drop and when we see less net buying, we see cash rise. We see more net buying, we see margin expansion, which we've been seeing, which is a good thing. But finally at the end of the day, we are seeing, even in the early going of 2011 at least to-date, cash continues to build in addition to net buying.

So that – I won't say that's a sustainable combination, but it is actually a very good situation to be in because we benefit clearly from low cost, stable customer cash. And in addition to that, we have been seeing net buying and we have seen our margin portfolio expand.

We need to do, I think, more work to understand it more fully, but it did exceed our own models and expectations during the fourth quarter. But the long trend is still a very good trend, more net customers of a higher quality and in proportion to that, we would expect more customer cash. And again that expansion of the balance sheet in the fourth quarter more than offset the decline in the net interest earnings spread of the portfolio. And for those of you who have read through, we actually, even though our spread has come down by roughly seven basis points, our NII in dollars went up by about $6 or $7 million during the quarter, which was quite, I think quite beneficial.

<Q – Michael Vinciquerra>: All right. Thank you, Steven. And just one question, I wanted to get a little more detail on this increase in the sales force. I know you mentioned that overall costs should be down slightly ex the restructuring and with some lower servicing costs. But on the comp line, it sounds like we should anticipate some increase. I guess it was, what, 325 or so in 2010. Should we be anticipating that line to show some growth and, I guess, ignoring potential for bonuses because obviously you can't make a call on how the company is going to perform necessarily?

<A – Steven Freiberg>: Yeah, without going line-by-line, just broadly speaking the objective that we have and I believe we will meet is to lower our overall cost base once again in 2011, but at the same time direct a more significant part of that lowering back into sales and marketing to grow the franchise. So one might expect, or should expect, expenses related to salespeople, but I can't comment on the aggregate line to increase. And I think that's good expense because these folks are driving more revenue, and in addition to that a higher investment in marketing and advertising and clearly driving the franchise forward as well. But I want to make sure that people are clear, don't expect expenses to rise, but expect essentially a smarter deployment of expenses in 2011.

<Q – Michael Vinciquerra>: And those folks will be on more -- mostly variable comp tied to asset production, things like that?

<A – Steven Freiberg>: We wouldn't have it any other way.

<Q – Michael Vinciquerra>: Okay. Thanks, Steve.

Operator: Your next question comes from Michael Carrier of Deutsche Bank.

<Q – Michael Carrier>: Thanks, guys. One other question on the expense base, if I look throughout the year there are a few items out there, so I just want to make sure. If we're looking at sort of a quarterly run rate of maybe like $280 million, is that roughly what you guys are saying is like a clean number for 2010 to base 2011 off of?

<A – Matthew Audette>: Hey, Mike, it's Matt. So I think if you look at Q4, the $305 million for the quarter, in the prepared remarks we highlighted the two items that we don't expect to recur that totaled $15 million.

<Q – Michael Carrier>: Yeah.

<A – Matthew Audette>: So just using those, you kind of get to your point of $290 million and then add to that Steve's comment the overall expenses for the year, which were just over $1.1 billion in 2010, we expect to come down slightly. So those are probably the two best things I can point you to on where expenses are going forward.

<A – Steven Freiberg>: But it sounds like the math is -

<Q – Michael Carrier>: Yeah.

<A – Matthew Audette>: Yeah, okay.

<Q – Michael Carrier>: Okay. That's helpful. And then just one other question on the balance sheet, it feels like the pick up in advertising, obviously that drove healthy account growth in net new asset and then like you said on the accounts, higher quality accounts, so you get more cash as well. When you guys are looking at, just the size of the balance sheet, the capital requirements and then the options that you have in terms of lowering deposit pricing to maybe push some of the cash out, how do you balance that? And it's still on the balance sheet, like what is the appropriate size? And how costly would it be to exit the wholesale funding, not from a cost standpoint but from the hedging that you have in place and swapping that out for the retail deposits over time?

<A – Steven Freiberg>: Yeah, I'll take a piece and I'll ask Matt to follow through. One, not to be flip about it, it's going to be hard to lower the rates since we hardly pay anything to begin with.

<Q – Michael Carrier>: Yeah.

<A – Steven Freiberg>: And we're all up – where most of our growth, in fact, really our primary growth is coming from, which is our brokerage suite, I think our stated rate now is 5 basis points. So if you think about it, most banks would kill for essentially intermediate duration funds, highly stable and we're paying roughly five basis points. So we've kind of gone I think on record to say that these tend to be price-insensitive and relatively speaking, inelastic balances. And it's kind of a relative commentary.

So on one hand, if somebody is willing to give you their money for, lets say, somewhere between two and four years on average for the price of five basis points per annum, we hope we can turn that into a profitable business, all things being considered and in this case without any additional credit risk, because clearly the way we invest the funds.

That said, an optimal size of the balance sheet, what we've talked about in the past and why it's hard to give you an absolute number, what we said is strategically we'd like our balance sheet over time to essential reflect in size the size of our customer franchise that is driving it. And within that, over a reasonable period of time, we would expect wholesale funding to basically decrease both in relative and absolute terms, although we do have commitments at this point that remain important to us on the wholesale side, either as for certain contingencies and/or for certain commitments that we've made in the past that it would be hard to exit.

But long term or intermediate term, the expectation is more of the money to drive the balance sheet that I've just addressed and we would have less wholesale, both in relative and over time in absolute dollars that would constitute this balance sheet. We're very focused on this area which is how do we maximize the value of the balance sheet to our shareholder and de-risk it at the same time, which has clearly been a parallel here, without really giving up a lot of the top line income and that is something that we're challenged by now, but expect over time to have more balance within this category.

But it's one of the areas as I cited in my prepared commentary, one of the four areas when I talk about the bank, it's more complicated. And I think you brought up the points then just looking at it from one perspective. But it's something we're actively engaged in.

<Q – Michael Carrier>: Okay. Thanks a lot.

Operator: Your next question comes from Joel Jeffery of KBW.

<Q – Joel Jeffrey>: Hi guys. Just curious to see if you're seeing any kind of negative impact on loan pre-payments from the mortgage rates going up?

<A – Steven Freiberg>: I'll ask maybe Bob?

<A – Robert Burton>: No. We really haven't seen much movement in our pre-payment rates over the last three months.

<A – Matthew Audette>: Actually they've been remarkably stable.

<A – Robert Burton>: Yeah.

<A – Matthew Audette>: Yeah.

<Q – Joel Jeffrey>: Is there any mortgage rate that would concern you guys in terms of this thing spiking to in the near term that you would think would actually cause pre-payments to slow?

<A – Robert Burton>: I don't know that I could speak to a specific rate. I think one of the issues of pre-payments clearly is that mortgage lending has gotten much tougher. It's harder for people to go out and get new loans and I think that's the significant factor that's really mitigating any movement in one direction or another in the pre-payment rate.

<Q – Joel Jeffrey>: Okay. And then just one other quick question, can you give us just a little bit more color on what the mix shift in your customer base that changed the increase in the revenue per trade?

<A – Michael Curcio>: Yeah, this is Mike Curcio. We had a strong – our option business continues to be strong and most of the mix change to the positive was on the corporate service side, where we had significant growth quarter over quarter.

<Q – Joel Jeffrey>: Yeah.

<A – Michael Curcio>: That's what you're seeing.

<A – Steven Freiberg>: And again I think you've heard it at either prior meetings that we've held. We do see the corporate services business or group important strategically and economically to the business and we're looking to accelerate growth there as well off a very strong market positioning.

We like it on several fronts, including the one Mike just cited, that the transactions coming through the corporate services group on balance have higher revenue yields than we get off a pure retail trade, all things being equal. And again, the option in futures mix in our business is consequential and continues to help support the level of commissions that we realized. And we were very happy with the overall commission rate in the fourth quarter of 2010.

<A – Robert Burton>: And the only thing I'd add is as well as the corporate service business is one of the chief drivers as well as our cash.

<A – Steven Freiberg>: Yeah.

<A – Robert Burton>: Is one reason why we always have strong cash balances.

<A – Steven Freiberg>: And I'm just going to say we have time for one more question. So bring it on.

Operator: Final question comes from Patrick O'Shaughnessy of Raymond James.

<A – Steven Freiberg>: Hi, Pat.

<Q – Patrick O'Shaughnessy>: Hey. Good evening, guys. If I just push a little bit further on the balance sheet discussion that's been talked about a little bit, so historically you've kind of been saying you want to work through some of these bad deposits or deposits to people who aren't your long-term customers and that would shrink the balance sheet. Are we at a point now where those bad deposits have kind of – you've gotten rid of the ones that you're going to get rid of and so maybe the balance sheet grows from here going forward?

<A – Steven Freiberg>: Well, just couple of points. Probably wouldn't call them bad deposits, but we would say definitively that all the deposits we have today come from our brokerage customers. We really exited the – what I would call the non-strategic stand-alone funding business when we sold the last tranche, which was roughly $1 billion to Discover and that was – that was the end of the first quarter. So today when you look at essentially the bank, the majority – I think we're approaching close to 80% now coming from – of the deposits are the suite deposits coming in from our brokerage customers. And the rest are more in a savings product, but the savings product is really being driven entirely by our customers as well.

So that aspect of shrinking the balance sheet as a function of having non-strategic deposits that were also reasonably high cost deposits, these were market driven deposits, that's all gone. And so right now the balance sheet and the growth in the fourth quarter was a perfect example that entirely $1.6 billion of deposits, 100% from our customer base, and all that roughly probably essentially a yield cost of roughly 5, 6 basis points at the end of the day. If we can continue to grow that aspect of the business, we think it has very good strategic and economic implications for our franchise

overall and may put some pressure upwards on the balance sheet, but that would be for a good purpose and a good reason.

<Q – Patrick O'Shaughnessy>: All right. I appreciate the explanation. And then a real quick follow-up slightly different topic, the restructuring charges that you had, you mentioned that it's going to lower some costs going forward. Can you pinpoint what those costs might be?

<A – Matthew Audette>: Sure. This is Matt. I think the primary component of our restructuring over the last probably two years has been associated with our international local business. So without going through specific line item by line item, that would be primary component and consistent with our overall comments on expenses going down slightly in 2011.

<Q – Patrick O'Shaughnessy>: All right. Great. Thank you.

Steven J. Freiberg, Chief Executive Officer

Okay. So let me just say thank you again for joining us tonight, and we look forward to speaking with you again next quarter. Good evening.

Operator: Thank you. This concludes today's conference. You may now disconnect.

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