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E*TRADE Financial Corp. *(ETFC)*

Q3 2011 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the E*TRADE Financial Third Quarter 2011 Earnings Conference Call. At this time, all participants have been placed in a listen-only mode. Following the formal remarks, we will open the call for Q&A. [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

*Head-Media Relations, E*TRADE Financial Corp.*

Good afternoon, and thank you for joining us for E*TRADE Financial's third quarter 2011 conference call. Joining 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 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 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 October 19, 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 maybe relied upon.

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

Steven J. Freiberg

*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

Good afternoon and thank you for joining today's call. I will begin by covering highlights from the third quarter, and then Matt will take you through the results. I will follow with a few additional comments, after which we will open up the call for questions.

We are pleased with our third quarter performance as we executed well during a period of extreme market volatility, driven by continued uncertainty in the global economy. We reported net income of $71 million or $0.24 per share on revenue of $507 million. Our results this quarter included a tax benefit as well as two specific expenses that I will summarize upfront and Matt will provide additional details later in the call.

First, we recorded an income tax benefit of approximately $62 million or $0.21 per share related to the taxable liquidation of European subsidiary in conjunction with our international restructuring. On the expense side, we reserved $55 million or $0.13 per share related to our intention to initiate an offer to purchase auction rate securities held by customers of E*TRADE Securities.

While we played a limited role in the market for these securities, we believe an offer to purchase is the appropriate thing to do for our customers and in the best interest of our stakeholders, and we will be pleased to put this matter behind us.

Also on the expense side, our quarterly FDIC expenses increased $12 million from the prior quarter, including $6 million related to second quarter premiums. The FDIC made changes to its assessment methodology effective in the second quarter and when the calculation of our new FDIC assessment was finalized in the third quarter, it resulted in a $6 million increase to the second quarter estimate.

So, while we had a tax benefit and two expenses that were unique to the period, it was a solid quarter as we continue to execute on our strategic plan and focus on creating franchise value.

The retail investor was highly engaged during this quarter, and we are proud that our team and our technology supported our customers through very volatile markets and we successfully managed periods that included record trade, call, online chat and login volumes.

In fact, we were recognized by SmartMoney on two occasions for having the fastest customer service response times and by website monitoring firm, gomez.com for being among the brokers with the fastest online trades on days of extreme volatility.

On August 8, specifically and on the heels of the U.S. debt downgrade, we processed 359,000 trades, a company record. Investors also increased their engagement via mobile devices and we saw a record mobile transactions more than 16,000 on that same day.

During this busy quarter, we continued to execute on our strategic plan by adding sales resources, expanding our product offering, emphasizing our corporate services solutions and managing our legacy loan portfolio. We are well on our way to increasing significantly our team of financial consultants and have grown this group by 33% year-to-date. This team is delivering quality accounts as evidenced by year-to-date asset growth of $8 billion, and we are very pleased with our momentum in this area.

For our more sophisticated customers, we introduced Pro Elite, an exclusive program that combines no-fee access to our premier customizable trading platform, E*TRADE Pro, with competitive pricing and priority service and support. We supported the launch with new television print and online advertisements and believe the program positions E*TRADE as the best choice for the active trader.

On the product front we launched portfolio margin accounts providing sophisticated traders with more flexibility to manage risk and leverage capital. We also added a number of enhancements to E*TRADE Pro and customers can now access a number of new features including, the ability to trade all option strategies expanded in CNBC content, algorithmic charts, cloud based layouts and the E*TRADE Community.

Our Corporate Services Group received a top rating in overall satisfaction and loyalty amongst stock plan administrators for the third year in a row as reported by Group Five, a third-party corporate services research firm.

In addition, we have now successfully deployed more than 200 clients on Equity Edge Online, our industry leading equity compensation platform that launched in 2010.

And with regard to our loan portfolio, we continue to decrease our credit cost and delinquency trends continue to improve including a 5% sequential decline in at-risk delinquencies. There is little doubt that the global economy will continue to present uncertainty, regardless we feel very good about our value propositions to both retail investors and institutional clients. We are pleased with the trends in our loan portfolio and the overall strengthening financial position. We remain optimistic about the opportunity to profitably grow our franchise.

I'll now turn the call over to Matt to take you through the numbers.

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Thank you, Steve. During the quarter, we recorded net income of $71 million or $0.24 per share compared with net income of $47 million or $0.16 per share in the prior quarter and net income of $8 million or $0.03 per share in the third quarter of 2010.

As Steve highlighted, our income tax provision this quarter included a benefit of approximately $62 million related to the taxable liquidation of a European subsidiary. The subsidiary was liquidated in connection with the company's international restructuring activities. This liquidation resulted in a taxable recognition of certain losses including historical acquisition premiums that company incurred internationally. This tax benefit resulted in a corresponding increase to our deferred tax asset, which currently stands at $1.5 billion.

In addition, it's important to note that approximately one-third of the deferred tax asset is on the parent company's balance sheet and is a potential source of corporate cash in future periods.

We generated $507 million of net revenue in the third quarter. This compares with net revenue of $518 million in the second quarter and an increase from $489 million in the same quarter of 2010.

Our third quarter revenue included net interest income of $306 million, a decline of $10 million from last quarter. This reflected a net interest spread of 2.81% on average interest-earning assets of $42.7 billion, down slightly from the second quarter's spread of 2.89% on $42.9 billion in assets.

Previously we have discussed that with our current balance sheet strategy we expect to produce a net interest spread of approximately 300 basis points in a normalized interest rate environment, and we still believe this to be true. However, if the current rate environment of extraordinarily low interest rates persist we would expect meaningful spread compression in future periods.

More specifically, we estimate our net interest spread could decline over time to approximately 250 basis points. I think it's important to note that this is not a forecast in any way, but rather a sensitivity analysis of the range of spread we believe our balance sheet would experience in the current interest rate environment and in more normalized interest rate environment. I would also highlight, this assumes no change in our current balance sheet strategy, which may also change over time.

Commissions, fees and service charges, principal transactions, and other revenue in the third quarter were $181 million, up from $174 million in the second quarter and a 20% increase over results from the same quarter of 2010.

This increase was driven by an 11% sequential and 30% year-over-year increase in DARTs. The increase was offset partially by a sequential decline in average commission per trade, from $11.14 to $10.76 driven by customer mix, specifically a lower mix of trades from stock plan customers related to market performance and volatility during the quarter.

Revenue this quarter also included $21 million of net gains on loans and securities, including net impairment of $3 million. The expenses, which increased by $51 million from the prior quarter, included a seasonal decline in advertising, a reserve related to auction rate securities and an increase in FDIC premiums.

As Steve mentioned, we reserved $55 million related to auction rate securities claims. This reserve relates to an agreement in principle between E*TRADE Securities and the Securities Commissioner of the state of Colorado and the North American Securities Administrators Association to settle our outstanding auction rate securities claims.

In connection with the settlement, E*TRADE Securities has agreed offer to purchase auction rates securities purchased through the firm by individual investors before February 11, 2008, and to pay a penalty on certain litigation and investigative costs.

The amount of the reserve relates primarily to our estimate of the securities' current fair value relative to their par value and includes other estimated settlement costs. We believe this offer to purchase is the appropriate thing to do for our customers and is in the best interest of our customers and stakeholders.

As it relates to FDIC insurance, premiums increased $12 million from the prior quarter, including approximately $6 million related to the second quarter of 2011. As you may recall, the FDIC made changes to its assessment methodology effective in the second quarter. When our new FDIC assessment calculation was finalized in the third quarter, it was $6 million higher than our second estimate. Going forward, the quarterly run rate will include this higher cost.

We believe it's also important to note that the new assessment methodology is an asset-based system with risk adjustments based on the size and quality of the balance sheet. So as we continue to de-risk our balance sheet, decrease our credit costs and improve our regulatory capital ratios, we would expect our FDIC costs to decline over time.

Turning now to the metrics. DARTs for the third quarter were 165,000, an 11% increase over last quarter and up 30% from a year ago. During the third quarter, net new brokerage accounts were 13,000, down from 25,000 in the prior quarter and up from 7,000 in the third quarter of 2010. Year-to-date, net new brokerage accounts were 89,000 comparing quite favorably to 27,000 for the same period in 2010.

Net new brokerage assets for the quarter were $2.6 billion. Through the end of September year-to-date brokerage assets inflows totaled $8 billion, compared with $5.7 billion acquired during the first three quarters of 2010. We ended the quarter with $26.1 billion of brokerage related cash, a decrease of $200 million during the quarter and up $3.5 billion or 15% compared with the brokerage cash balance on September 30, 2010. Customers were net buyers of $2.2 billion of securities during the quarter. Average margin receivables declined by 5% sequentially from $5.7 billion to $5.4 billion, and were up 15% over the same period in 2010.

We continue to be pleased with the performance of our legacy loan portfolio and with the success of our loss mitigation activities. The portfolio contracted by approximately $700 million during the quarter. We reported a meaningful decline in net charge-offs and delinquency trends continue to be favorable.

Our loan loss provision was $98 million, down 5% from $103 million in the second quarter and down 35% from $152 million in the third quarter of 2010. We expect favorable trends to continue over the long-term, although they are subject to volatility in any given quarter.

Loan charge-offs declined by approximately $21 million in the third quarter to $157 million and were down from the $222 million we reported in the third quarter of 2010. The allowance for loan losses at quarter end was approximately $800 million. The performance of our legacy loan portfolio continues to benefit from aggressive loss mitigation strategies, including the use of servicers that specialize in troubled assets. As we discussed in our second quarter conference call, we transferred $1.4 billion in loans to such servicers in the month of July.

These special servicers focus on loan modifications, often pursuing trial modifications for loans that are more than 180 days delinquent. The large transfer of loans during the quarter combined with this focus on late-stage delinquencies resulted in increase in TDR delinquencies for loans of 180 days or more past due during the quarter.

After the successful completion of the trial period, typically 90 days, the loan will become current. There is no impact on the allowance for these modified loans as they had already been written down to the expected recovery value when they became 180 days past due.

Overall, we continue to be pleased with the performance of our modified loan portfolio. Specifically, we saw an improvement in the average re-delinquency rates 12 months after modifications for both one- to four-family loans, which was down to 28% versus 31% in the second quarter and home equity loans, which was down to 42% versus 43% in the prior quarter.

Moving now to capital, the bank generated $147 million of regulatory risk-based capital and $76 million of Tier 1 capital in the third quarter. As of September 30th, E*TRADE Bank's Tier 1 capital ratio was 8.1% and its risk-based capital ratio was 17.2%.

With respect to our parent capital ratios, all of our required ratios were above the well capitalized minimums. In addition, our consolidated Tier 1 common ratio was 9.3%. We also continue to track our consolidated ratios under Basel III requirements. We believe that Basel III in its current form will increase this ratio by approximately 20 basis points to 9.5%, meaning we estimate we are above the 2019 fully phased-in requirements today. The main reason for the increase, the Tier 1 common ratio under Basel III, is the difference in capital treatment of unrealized gains and losses on available-for-sale securities.

Turning now to dividends of excess capital out of our bank; since late 2009, the company has requested and received the approval of our primary regulator to send quarterly dividends from our bank to our parent.

The dividend had been equal to E*TRADE Securities, our introducing broker-dealer, profits from the previous quarter. We believe our former regulator, the OTS, viewed these dividend requests as distinct from a more comprehensive request to release a portion of the bank's excess capital.

During the quarter, we transitioned regulators from the OTS to the OCC and the Fed. We believe our new regulators would view all dividend requests with an equal level of scrutiny. Therefore, rather than pursue a request solely for E*TRADE Securities' profits during the quarter, we believe the best path for our shareholders is to work on a comprehensive dividend plan that could efficiently distribute capital amongst our regulated entities and parent company.

We have begun this process and our expectation is that it could take several quarters to conduct and we cannot predict the likelihood or timing of regulatory approval for any such dividends.

Moving now to corporate cash, we ended the quarter with $438 million compared with $424 million at the end of the second quarter. To summarize, we are pleased with our quarterly and year-to-date performance. And although we are more certainly not immune to the challenges of the macro environment, we are confident that our strategy supported by declining credit costs and an increasingly strong financial position provides us the flexibility to execute through uncertain times.

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

Steven J. Freiberg

*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

Thank you, Matt. Before taking questions, I would like to share a few additional comments. We are very pleased with the quarterly and year-to-date performance as we continue to execute on the plan we laid out one year ago on this same call.

Customer metrics are strong, and our corporate businesses continue to gain momentum, while our credit outlook and capital position continue to improve each quarter. We have shown meaningful progress this year in a number of key measures, including new accounts, asset flows and earnings. Comparing year-to-date results with the same period in 2010, we have added more than three times the number of net new brokerage accounts, brokerage inflows are up 40%, and we have generated $163 million in net income compared with $4 million loss in the third quarter of 2010.

Looking ahead, as evidenced by the increased activity in August, it is not possible to predict the markets or how the retail investors might engage in the short-term. As it relates to October, month-to-date DARTs are flat compared with September. Regardless of short-term volatility, though, we are optimistic that E*TRADE is well positioned to meet the needs of both traders and investors today and over the long-term.

We continue to focus on initiatives that support our mission to deliver the best investing experience, and plan over the next few quarters to introduce a number of enhancements to the customer and prospect experience. Later this month, we will introduce enhancements for option traders, including advanced screener, analyzer and optimizer tools, followed by other new products for traders early next year.

We continue to add customers to the beta version of E*TRADE 360, our new personalized investing experience that allows customers to access all accounts and their favorite features on a single page.

It will be differentiated in that the platform will be available to all customers from the beginner investor to the most sophisticated traders. We expect to make E*TRADE 360 available to all customers in mid-December and launch officially with additional features in early 2012. Also in December, we plan to launch a new prospect website, introducing an enhanced visual and navigational experience that we believe will increase prospect engagement and conversion. We should transition to this new site entirely by the end of January. We will continue to add sales resources in both our retail and corporate sales teams as we build on our momentum and focus on asset and high-quality account growth.

Finally, during the quarter we engaged Goldman Sachs to conduct a strategic review of our business to ensure we're maximizing value for all shareholders. While the Committee and the Board are making good progress, at this point, there is no additional information to share, so I'll not have anything more to add this evening.

Again, we are pleased with our third quarter performance and looking forward to building on our progress as we close out the year and move into 2012.

With that, operator, we're ready to take questions.

QUESTION AND ANSWER SECTION

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

Daniel F. Harris
Analyst, Goldman Sachs & Co.

Q

Thanks, guys. Good afternoon. I appreciate the color you guys gave around the NIM and where you expected that could go to. I was wondering if you could put just a little more timing around that, if things stayed the same and we do get to the 250 basis points, is that over four, six quarters, how long would you think that would take and what are your assumptions built into that for margin loan deterioration, if at all?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Hey Dan, this is Matt. So as far as the balance sheet strategy that would ultimately lead to 250 in this interest rate environment, it's the strategy we're executing now, so it's focusing on a balance sheet funded by customer deposits. Our expectation is that that customer base grows, that margin loan grows along with that and the legacy loan portfolio continues to run off, and the investment strategy is in little to no interest rate and credit risk assets. Specific on when we would hit that 250, there's no particular timeframe on that other than if this current interest rate environment persists that is our expectation of where it could go down to. It's not years and it's not tomorrow, so it's probably the best way I could put it for you.

Daniel F. Harris
Analyst, Goldman Sachs & Co.

Q

Okay. No, that's perfect. Thanks very much. Staying on the balance sheet, looks like for the – pretty much for the last year we've been right around $42 billion, edging up to $43 billion on the balance sheet and I think that's where, Steve, you had said that that's a position you feel is comfortable. Any update on that, do you anticipate what the amount of deposits that are out there that would like to find a home that that could grow or are you comfortable at that $41 billion, $42 billion mark?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Yeah. I think in several conversations on the topic, we really did indicate that we don't have a precise number that we target that the balance sheet ultimately will be driven, meaning it's sized by the quality inside the deposit base that's generated by our E*TRADE customers. So, we would expect it to grow with the passage of time, but in line with the needs of our customer base.

It's been relatively stable for a while, basically some volatility as customers have held more or less cash depending upon the environment, but I think sort of a normal view would be, if we grow our customer base 5%, 6% a year, that the balance sheet probably grows in line with that, although I would say there is opportunity with the passage of time to diminish the use because there's still a sizable amount of wholesale funding that's on the balance sheet that's both high cost and non-strategic. There's limits on how low it can go, but that said, I think again, the balance sheet will be driven by the franchise size and the franchise needs.

Daniel F. Harris
Analyst, Goldman Sachs & Co.

Q

Okay. Great. No, that's very helpful. Just last for me on a different topic here, on the market making side, I was little surprised to see the equity shares traded drop by close to 40%, yet your revenue capture was up by almost double. What are you seeing there that drove that change and what should we expect going forward? Thanks a lot.

Michael J. Curcio
*Executive Vice President, E*TRADE Financial Corp.*

A

Hi. It's Mike Curcio, great question. Basically it's a mix issue, so we saw a much more trading in NMS issues, which are more profitable and less trading in the bulletin boards and we're seeing on the retail side a lot of traders are seeing better opportunities in NMS these days. So that's what attributed to that mix change.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

It wasn't a strategic shift essentially, it was basically the markets really selecting where they wanted to focus or concentrate, so that's going to move around. But clearly to Mike's point, basically the revenue per share is clearly more compelling in the mix even though the actual volumes – the volumes have come down substantially, although we can't predict that could shift around in any given month.

Daniel F. Harris
Analyst, Goldman Sachs & Co.

Q

Okay. Thanks, guys.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

All right, Dan. Thanks.

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

Patrick J. O'Shaughnessy
Analyst, Raymond James & Associates

Q

Hey, good afternoon, guys.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Hi, Pat.

Patrick J. O'Shaughnessy
Analyst, Raymond James & Associates

Q

First question I wanted to ask you, touching on the interest spread again. What is it structurally about your balance sheet that might protect it maybe more so than some other online brokers out there, and by that I mean if you look at some of the other online brokers, that are having the interest margins below 2%, do you guys obviously kind of see yourself normalized at 3% in this environment, maybe down at 2.5%. What is it structurally that maybe keeps your net interest spread maybe a little bit higher than some of the other online brokers out there?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Hey Patrick, it's Matt. I think the – just talking specifically to our customer base, when you think about a balance sheet funded almost entirely by your own customer deposits and non-maturity deposits, the spread that you can achieve on that is as unique to the firm as it is to your customer base. Meaning it's driven by the stickiness and the customer behavior of that cash, so focusing specifically on us we think the sweep deposits are not a rate product. They're a product of convenience and they're extremely sticky and we think that is one of the biggest drivers that ultimately leads to 300 basis points, but every firm is different. So our customer base we think is – and the cash associated with it is the big driver of that.

Steven J. Freiberg A
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

Yeah. And just – and I think you've seen, Pat, the shift over the last probably 12 to 18 months, more and more of our customer cash is in our sweep product, to Matt's point, less is in a savings-oriented product where the customer specifically was oriented towards rate and that shift has been quite substantial. So with low rate sensitivity deposits that tend to have longer duration, we probably have a better opportunity to take advantage of the curve. That said and we've emphasized this and we know when it's systemic, our preference is to have a steep curve and one that's elevated in absolute terms from where it is. But in the absence of that and to Matt's point, we think the range that we've laid out is a reasonable view, although it could go higher and/or lower than that range, but we would say that range captures the vast majority of the scenarios that we think are likely, although clearly it's not definitive by its very nature.

Patrick J. O'Shaughnessy Q
Analyst, Raymond James & Associates

Okay, fair enough, I appreciate the clarity there. And then there's a follow-up question, when we look at your – the deposits in the bank this past quarter, it's actually down slightly quarter-over-quarter. Is that just a function of your customers were net buyers during the period and they moved some money from cash into securities or...?

Steven J. Freiberg A
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

Yeah. Actually, you picked up exactly. Our customers surprisingly were very strong net buyers during the quarter. I recall the number being approximately $2.6 billion...

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

$2 billion.

Steven J. Freiberg A
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

No, it was $2 billion net.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

$2.2 billion.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

$2.2 billion. And so if you think about it, I believe our deposits were down – yeah I think approximately $200 million.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yeah. So Patrick, if you look at the brokerage related cash, it's down from $26.3 billion to $26.1 billion.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Yes. So the brokerage cash was down minimally, yet our customers were substantial buyers of securities during the period. So, net, net they absorbed a small piece of the cash they held with us, but really brought new resources to the firm in order to execute their transactions.

Patrick J. O'Shaughnessy
Analyst, Raymond James & Associates

Q

Okay, great. I appreciate the clarity. Thank you.

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

Richard H. Repetto
Analyst, Sandler O'Neill & Partners

Q

Yeah, good evening, Steve, and good evening, Matt.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Hey, Rich.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners

Q

I guess the first question is, Matt, you explained sort of the TDR the – in the 180-day delinquencies – I'm sorry, but I wasn't able to catch the full explanation there, but the rationale or the driver behind the up-tick in the delinquencies on the TDR's the 180 days?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Sure, Rich. I think historically our modification programs have been focused on delinquent loans. In connection with the servicing transfer this quarter we've started the focus on trial modifications and the trial modifications are focused almost entirely on loans that are 180 days delinquent. So your typical modification, you agree with the terms of the borrower, they make the payment, you make them current and they go along their way.

On the trial modifications, typically loans are in the process of foreclosure. So we typically require that they make three payments in a row because if we officially agree to modification you would stop the foreclosure process and if they miss the second payment you got to start it up again. So it gets very costly to do that.

So we wait for three payments to occur and then make it current. But what you're seeing in that 180 days delinquent bucket is during that trial period we continue to report them in that 180 days, but once they make that third payment we'll move it current.

The other thing probably important to highlight, Rich, is these are loans that are in the process of foreclosures, they've already been written down to their estimated recovery value, so we think anything that we do here there's only upside. Worst case it doesn't work and the costs are just the same as we previously thought they were.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners

Q

Got it. That's helpful. And next just on the revenue side just a couple of small line items here, but the gain on sale of securities sort of went down sequentially $6 million or $7 million as well as fees and services, and I know you've given guidance that it would go down, but is this sort of the more appropriate run rate going forward for both these lines or any color you can give us?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

So the short answer to the question, Rich, is yes. On the gain on sale side I think going back to 2009 and '10 that on an annualized basis those bounced around the $150 million range, back when rates were a lot more volatile than they've been this year, although the past couple of months they were a little bit volatile. But our expectation is that gain on sale line when compared to the $150 million range per year is certainly going to come down.

Specific to fees and service charges we had a little bit of lumpiness last quarter with some corporate action specifically the Citi reverse stock split that created some lumpiness in the fees. So we saw that come down to a more normalized level this quarter.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners

Q

Got it. Okay. And then lastly, Steve, I respect the guidance. So you put in the prepared remarks about the strategic review. But, I will ask a question, when it does come to conclusion or when you get to the findings that they ultimately come to, will there be – I'm just trying to find is there a conclusion to this? Is there going to be – will you discuss this on a conference call later or how do we expect to end this?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Rich, good question. Clearly there will be a conclusion for obvious reasons. How we would convey that externally, I don't have a definitive view yet to provide you, although expectations, since we publicly said we've engaged and initiated, we will need a process to bring it to closure both internally and externally. So when we're ready I am sure you will be on the invited list as someone who has tracked the firm and been important to the firm over the years, but at this point in time it's just something I can't give you precision on. Although, as you might expect, as much as you want to hear the conclusion, we would like to bring the process to closure and move forward. So stay tuned, but I just can't give a precise answer yet. Although since it is a public process so to speak at least as we initiate it we will bring it to a level of closure.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners

Q

Understood. Thank you for the answer very much.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

And Rich appreciate your respecting the process.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners

Q

Absolutely.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Okay.

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

Howard H. Chen
Analyst, Credit Suisse (United States)

Q

Hi, Steve, hi, Matt.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Hi Howard.

Howard H. Chen
Analyst, Credit Suisse (United States)

Q

Back on the investment side, just curious what type of securities you're investing in today, what duration those are and maybe what types of yields you're getting.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Yeah. So there's been no change in strategy there. So it's low interest rate risk, low credit risks assets, which essentially means the agency securities. Our philosophy is really to match the duration of deposits, so it's typically been in the 2.5 to 3-year range and that continues to be the focus on the asset side.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Right. So again, the duration runs in that 2.5 to 3, but the instruments will cover a very broad part of the curve.

Howard H. Chen
Analyst, Credit Suisse (United States)
Q

Sure. Great. Thanks. And then on your commentary, the increase in DTA at the parent company, just under what conditions will lead to a release of that or something that you can use to invest in the business or deploy, etcetera?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

It's I think it's pretty simple it's income. So over time as we earn income, we won't have to pay taxes on that income and that will release the DTA. So of that $1.5 billion, $1 billion is essentially in the bank structure, and $0.5 billion is at the parent, so ultimately that will turn into cash to the avoidance of paying taxes.

Howard H. Chen
Analyst, Credit Suisse (United States)
Q

Okay. Thanks. That's helpful, Matt. And then finally for me, just on your commentary on the comprehensive plan, I know we have a few quarters here, but could you just help frame the parameters of the discussion of how you think about the excess capital and deploying that in this new context of broader more comprehensive plan?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Sure. So if you look at the bank, we have broadly $3.5 billion of capital. And if you look at all the different measures, anywhere from $1.3 billion of that to $1.5 billion of that's considered excess at least on the official guidelines. So from our perspective, given we have $1.5 billion of debt at the parent, we would like to have the flexibility to officially manage that for the best interest of our shareholders. So you can expect that is the type of dialogue we would have.

From a regulatory perspective, you can expect that they have certain others perspectives as well. So we're going to work through that. So we expect it to take several quarters to do so. So I would highlight that we're fairly comfortable going through that time period, given the level of corporate cash we have, which is slightly in excess of $430 million and given that we just refinanced our nearest maturity over the summer so our nearest maturity is now not until 2015. So we have well in excess of two years of debt service coverage, which is about $175 million a year, so we feel like we've got a decent runway here to work through this comprehensive plan.

Howard H. Chen
Analyst, Credit Suisse (United States)
Q

Maybe as a follow-up to that, Matt, just to confirm in very simple terms for me, so if you think you have $1 billion to $1.5 billion that you could upstream in the bank, you think you would like to use that to delever at the parent, and so you kind of view the size of de-levering with the excess capital that you have in the bank as kind of one for one.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So we'd certainly like to upstream it to the parent. I think the $1.3 billion to $1.5 billion is the excess above the regulatory minimums and I think everybody could expect in this environment for quite some time your regulators wouldn't allow you to dividend all of that up. But that's just to frame the discussion, that's where we would be focused, is on that excess capital.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Yeah. I think, just to add, Howard that I think the flexibility will be available to us with the passage of time, although we can't predict with any certainty time. What really happens, which is a continuation of the trend that we've been on for a while, which is improve the risk profile of the company, improve the earnings and the quality of the earnings of the company and improve the capital position of both the bank and the parent; and as long as we continue down that path, I think it will give us many more degrees of freedom and that's what we basically aim to work towards.

And from your question of how we deploy it, I think again in part it's obvious that we are carrying a very heavy burden of the past sort of a tax from the credit crisis, the loan was basically – the debt service being one of the burdens that we'd like to correct for, and I think Matt summed it up well, but there are other areas that we would invest in the company with the passage of time, but probably not prepared today to go in any detail. That was the most direct and most obvious.

Howard H. Chen
Analyst, Credit Suisse (United States)
Q

Okay, thanks, Steve, that's helpful.

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

Michael Carrier
Analyst, Deutsche Bank Securities, Inc.
Q

Thanks guys. Just one more question on the capital side. It seems if you give the Basel III Tier 1 Common, if you're above 9% at this point, I think that would be the only firm out there. So it seems like, from a capital standpoint, you'd be fine. But even when you think about going forward, because whether it's the capital that you have today or the capital that you're going to generate over the next 6 to 18 months, we can calculate that, but where do you think you would be comfortable, in terms of keeping that ratio and then based on what your conversations are with the regulators?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So the 9.3%, Michael, is at the parent. So I think we're focused on the banks. So the Tier 1 leverage ratio at the parent's at 8.1% and the risk based capital ratio is at 17.2%. So depending on where the regulators focus, those will be the two ratios that will be most relevant to how much we could upstream, and the dollars in excess of those two that's that $1.3 billion to $1.5 billion I referenced. So it's an area to have the dialogue what they would ultimately be comfortable with us upstreaming versus what we would desire I think that will play out over time. I think our objective though is just to have the most efficient distribution of capital between the bank and the parent in the future.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Yeah, and again I think it's just worth emphasizing that if the regulators would speak, and this is obvious that it's not unique to our firm, just to what I said earlier. This is not a binary item. It's essentially it will change with the passage of time, again, on what is the risk profile of the company, what is the capital position, which is the point you made of the company, and what is essentially the earnings of the company, which clearly is future capital. So, I think, if we look at it, it's dynamic. It basically will change with the passage of time, and we also know the environment will change with the passage of time, maybe better, maybe not so much better as the regulators assess what they believe is necessary for the safety and soundness of any institution, including our own. And we're not trying to avoid anything direct just to say that we know what we need to do with the passage of time to put ourselves in a better position, so we can gain more flexibility. But it is a moving target, it is dynamic but it is important, because that flexibility over time is important for us to have essentially a world-class franchise.

Michael Carrier Q
Analyst, Deutsche Bank Securities, Inc.

Got it. That's helpful. And then just the one follow-up. On the expenses, I guess just two questions on that. Anything unusual, obviously ex the reserve, got that, any of the line items. And I guess the only one that stands out is the clearing and servicing, so not sure if the transfer of some of those loans had an impact. Typically seasonally in this quarter you would expect that to be a little weaker, but given the volumes in the industry, I might think that it would be a little bit higher, so just anything unusual in that line item or overall on the expense side?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

So, the two main items are the auction rate securities reserve and the increased FDIC insurance premiums. On clearing and servicing, so that line does include a lot of the costs associated with the risk mitigation activities, so that can be pretty lumpy. You saw a little bit of an uptick in that in the second quarter and saw that come back down to call it more normalized levels this quarter. So it's just the lumpiness associated with that activity.

Michael Carrier Q
Analyst, Deutsche Bank Securities, Inc.

Okay. Thanks, guys.

Operator: The next question comes from Chris Allen of Evercore.

Chris J. Allen Q
Analyst, Evercore Partners (Securities)

Good afternoon, guys.

Steven J. Freiberg A
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

Afternoon.

Chris J. Allen Q
Analyst, Evercore Partners (Securities)

Just going back to kind of Dan's questions and I think you guys have done a good job in terms of explaining the balance sheet strategy, but if you can walk through just some of the mechanics in terms of how the NIM, the spread would decline, is it more a function of variable – excuse me, variable rate loans repricing, new assets coming on at lower spreads in the securities portfolio? If you can just give us some clarity around that would be helpful.

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Sure, Chris. This is Matt. So exactly what you just highlighted, so on the asset side, as the legacy loans pay down at higher rates, you get the reinvestment at much lower rates today. We also – as Steve commented earlier, we do have a wholesale book that we raised back in '07 and '08 which were at much higher cost over time that will run off which will actually improve it. But I think the gating factor here is the interest rate environment. So a company that funds itself with customer deposits in an interest rate environment of extraordinarily low rates, just the amount of spread you earn on those deposits is just much lower. So that's going to manifest itself in a lower spread over time.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Got it. And then, I mean, just how much of the securities book is rolling over on a quarterly basis at this point?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Legacy assets, I think...

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So the loan portfolio came down $700 million during the quarter. The securities portfolio is not a run-off portfolio and so there's a lot of buying and selling as well as pay-down activity in there. So there's not a clean metric to give you there. But on the loan portfolio, it was about $700 million for the quarter.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Yeah. To put it in broad stroke, if the average duration is, let's say, a little less than three years, you can probably do your own back of the envelope math as to what that would imply from the standpoint of what [ph] rollls it has to be reinvested in at a given period.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Sure, we'll do that. And then just one other question, any commentary on the decline in advertising spending? Obviously, we expect it to kind of come in from a seasonal perspective, but seem to be...

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Yes, exactly. You got – you hit it on the head. It's exactly that, summer months basically reflect seasonality and you would expect the fourth quarter to rebound to its normal seasonality, which tends to be typically one of the better quarters all-in-all from the standpoint of being in the marketing business and that probably cascades right back into the first quarter.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Got it. And then any change in the thinking on spending on advertising given the environment right now?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

I would say that other than on the margin where we basically ebb and flow I think broadly, our strategy is intact.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Great. Thanks, guys.

Operator: Your next question comes from Brian Bedell of ISI Group.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Hi. Good afternoon, folks.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Hey, Brian.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Hi. Just couple of follow-ups. Just on – going back to the dividend strategy, dividending the cash up from the bank, if you get to a point, let's say, at the end of next year when you have that first potential hit at the springing lien notes, and you haven't been approved to dividend cash up, is there enough – will there potentially be enough cash with some of the DTA being able to be deployed in the corporate cash you have in the balance sheet plus what you're earning to still potentially retire the springing lien notes even without dividending the extra cash up from the bank?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So, Brian, so the December 2012, call it, certainly our focus. I think that there is a lot of different things that impact corporate cash. I think the key thing to focus on here is the current level of cash. It's just over $430 million. No maturities of debt until 2015. I mean, yes, the DTA at the parent, that $500 million ultimately would become cash at the parent. That all depends on earnings over that same period of time, so it certainly could be volatile, but it is a potential – certainly a potential source.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Right. But do you actually need to dividend from the bank to actually try to retire the springing lien notes? I guess is it dependent upon your success with the comprehensive dividend plan?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Sure. I think the math ends up being pretty simple. There's $1 billion of those notes, they'd be callable at 112%. So you're talking over $1 billion and in the current corporate cash there's $400 million. So there'll definitely need to be a source if you were to going to call those in their entirety.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc. Q

At least some of it, okay, okay, great. And then I calculated your effective tax rate at about 40%, is that correct and is that a good ongoing run rate for a normalized tax rate?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.* A

Yeah, Brian. It's going to bounce around in the low 40s. The key distinction there making it above the actual federal rate of 35% as well as some state noise is about a third of that interest in the springing lien notes is not tax deductible. So at some point in the future when those aren't around, it would actually improve it, but in the short term the low 40s is a good assumption.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc. Q

Okay, great. And then...

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.* A

Just a point. Let me just – just want to remind folks that because of the DTA and the like, even though the rate's high, just remember we're not paying cash taxes.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc. Q

Right. Yeah, yeah, definitely. And just on the net interest margin, just on one area, the wholesale borrowing cost – in your assumption of a static rate environment, do those wholesale borrowing costs that you have right now change significantly over the next several quarters or couple of years, in terms of the actual – the rate you're paying on them?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.* A

Yeah, so the wholesale borrowing book, it's going to take a long time to run off, those were brought on board in '07 and '08 when liquidity was at a premium so we've locked those up for a long period of time.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.* A

Yeah. Unfortunately there's not a lot we can do at this point and this is sort of – if you put it in perspective at least the way I view it sort of the legacy costs that we're still incurring, that's one of them and you could do the math as to what wholesale is versus if we replace that with customer. You also – you've made the point on the high cost of our debt. We, I think, made a point during the prepared remarks that our FDIC insurance premiums now are high relative to what we expect. This is a relative comment, but it also translates to absolutes, that if the profile of the company improves, those costs will come down and finally with the passage of time we're still carrying a very heavy burden on provisioning that we expect will over the course of time also come down. So all those items sort of vector in the right direction, but they all require time.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Great, yeah. And then just on the actual rate on that wholesale borrowing, the yield that you're paying, in your scenario Matt, did you expect that rate to say roughly around the same where it is in the third quarter, in that 250 scenario?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So the wholesale borrowing book is locked up but both in balance and roughly in rate for that long period of time.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Okay.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So neither would really move much.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

That answers it, great. Thank you so much.

Operator: Your next question comes from Chris Harris of Wells Fargo.

Chris Harris
Analyst, Wells Fargo Advisors LLC
Q

Hey, good evening, guys.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Evening.

Chris Harris
Analyst, Wells Fargo Advisors LLC
Q

I want to come back to the net interest here. Assuming there is some degradation heading into next year, I'm just curious what kind of flexibility do you guys have on the expense side to maybe offset some of that decline in revenue if any?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So, expenses are certainly going to be a focus, especially the more challenging the environment gets, I think any company, ourselves included, would certainly focus on expenses, but I think the gating factor on net interest spread and ultimately that going to the bottom line is going to be the interest rate environment. So there are certainly some things you can do on the expense side, but the spread in this environment would continue to be challenging.

Chris Harris
Analyst, Wells Fargo Advisors LLC

Q

Okay, fair enough. And then with respect to your attrition, I know you guys have made a lot of improvements here, attrition rate's really come down a lot from kind of the peak levels, but you're still running at double-digit percentages and above your peers. I'm just curious is that really – what's really driving the accounts moving out and what kind of initiatives can you guys put into place to try to drive that down further?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

A

Yeah. It's just for perspective for the rest of the group. If we went back two years the attrition rate at E*TRADE was approximately 15% and the company through a number of actions has effectively brought it down to just about 10% to 10.5%. So we've made a lot of progress over that point of time, which is important.

Part of the differential is that we believe a stricter definition of what's an open active account versus maybe industry norm. So, we basically – when accounts have few assets within, and I think we're using, yeah, less than $25, we effectively – the account is closed and we count that as an attrited account.

We don't believe – in fact we know for a fact the industry doesn't use that standard. So, what we've experienced particularly this year when we had the market prior to the last two months take a substantial decrease in value, a number of accounts fell into that. So what you could argue, because we track this as you would expect not only in the aggregate, which is important, but by segment on where our income is really derived from. What I will tell you is, the customers that really drive this franchise, the attrition rates are in the 2%, 3% range and they are extraordinarily good and strong. It's on that margin where you're really trading off not only the definition, but the quality of the account and what's the incremental cost to keep someone versus the incremental benefit.

We don't have, I don't have – I can't tell you that we're going to drive to 10 to 8, even though we would like to, what we will say is that we'll spend what we need to spend in order to drive the attrition rate to a level that makes economic sense for the franchise. And I don't know if that helps you, but it probably gives you some color. We manage it by segment. We report in the aggregate, but we also have a definition that we think is a bit more firm than others that basically we compete with – within the industry.

So we feel good about progress we made. We feel good about the segments. Would I like it to be lower? The answer is yes. It doesn't make economic sense for us to drive it lower. I can't tell you if this has to be done from the bottoms up, not the top down.

Chris Harris
Analyst, Wells Fargo Advisors LLC

Q

All right it does help, Steve. Thank you. And last question here from me, real quick. It sounds like you've had some improvement in your re-default rates, I guess for the last 12 months. Now that you guys got some higher quality of servicers in there for large portion of your portfolio, what are you expecting there, are you expecting a continued decline in the re-default rate? Maybe if you can kind of quantify that first, if possible?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Sure. You're referring to the modified at 12 months re-default rate?

Chris Harris
Analyst, Wells Fargo Advisors LLC
Q

Correct.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Yeah. So I think the servicers is definitely going to have an impact, and you're going to see that impact over time. I wouldn't get too precise on the number other than to reiterate that the 28% re-delinquency rate on the one-to-fours and the 42% on the home equity, we feel really good about those. And certainly, they could go down from there, but I think at those levels we feel good now. So, we think the program has done well and we're going to continue to focus on that.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Yeah. I mean it really is more – I think it's a good story not only for E*TRADE, but for the customers that have gone through the modification program. We think there is economic benefit to the firm that's real and it's measurable. And at the same time, the individual gets to stay within their home and has the capacity to actually – or the liquidity of the cash flow to actually make payments.

And we were pleasantly surprised not only with the absolute number, but the trend. And when we look at external data and there is not a lot around, we think it basically benchmarks extraordinarily well. And so, we also have learned over time, I think to be better selective and provide a more tailored solution to the needs of our particular – that particular customer.

But again, to Matt's point, we can't predict the 28 or the 29 or the 26, but directionally, we've gotten better in just about every vintage and in addition to that I think the absolute number or the range that it's in now is quite compelling.

Chris Harris
Analyst, Wells Fargo Advisors LLC
Q

Thanks, guys.

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

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Good evening, guys.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Good evening.

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

I just had a quick question on the timing of the ARS charge was that any way related to the switch in regulators and their interest in having us behind you guys before they start to allow you to return capital to shareholders?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

The answer is no, it's been an issue that's been out there for quite a while, I would say the quarter in which we made the decision to move down this path was completely independent, it just basically coincidental to a change in regulators.

I just feel good as the CEO of the company that it's been an issue that's been out there for a while and that we've had an opportunity now to start the process to put it behind us and that's important. Again a lot of the legacy of the crisis, the more of that that we can put behind us the more we can focus on our competition and the franchise and that's really where we should be putting our energy. So it was just purely coincidental that it happened within the same quarter.

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay and what was the maximum client exposure?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

At its peak the clients had just north of $800 million of ARS within their accounts. We got to go back probably 3, 3.5 years and the number basically in the last reporting period was approximately 125 that would've been at the end of the second quarter. Clearly it's lower today than it was then, but as you would expect that residual meaning what's left is by definition less liquid and more challenge and therefore the reserve is reflective of that.

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay. Great. And then just lastly, I mean, with the new Volcker Rule proposals coming out just wondering what your thoughts are and how that could impact your market making business? Would it just be heightened compliance costs or anything along those lines?

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*
A

Yeah, there would be some incremental costs on both – management, compliance and other related, but not substantial. And we have a very small prop desk, so to call, but you wouldn't see it if you look for it through the standpoint in our revenues or our income in fact, the last data point I can recall, which is 2010, I think we generated about $300,000 of revenue off that activity and that was of the $2.1 billion, $2.2 billion revenue base. So it's really not of consequence from the business model standpoint on prop trading, but on market making we continue to basically support, very proud of the business and whatever the incremental costs are, it will not change our business model.

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Great. Thanks for taking my questions.

Operator: At this time there are no further questions. I will now turn the floor back over to Mr. Steven Freiberg for any closing remarks.

Steven J. Freiberg
*Chairman & Chief Executive Officer, E*TRADE Financial Corp.*

Okay. Thank you again for joining us tonight and we look forward to speaking with you again next quarter and good evening to everyone.

Operator: Thank you. This concludes your conference. You may now disconnect.