
MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the E*TRADE Financial First 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

Thank you. Good afternoon, and thank you for joining us for E*TRADE Financial's first quarter 2011 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 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 April 20, 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 p.m. 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. I will begin by covering the highlights from the first quarter, and then Matt will take you through the results. I will conclude with a few additional comments, after which we will be happy to take your questions.

E*TRADE is off to a terrific start in 2011. We reported net income of \$45 million or \$0.16 per share on revenue of \$537 million. Our progress was a result of significantly improved metrics in our brokerage business, an increase in interest and non-interest revenue, positive trends in our loan portfolio, and focused expense management.

The retail investor showed increased engagement during the quarter, driving healthy growth in DARTs, brokerage accounts, and margin receivables. Net new brokerage assets of \$3.9 billion were the highest we've ever recorded. Our loan loss provision declined on positive credit trends, and expenses declined sequentially even as we invested in sales, service, and marketing initiatives.

Overall, we are very pleased with our quarterly performance, which demonstrated solid progress in strategy execution. This was evidenced by the significant increase in high quality net new brokerage accounts that are utilizing the franchise's broad range of trading and investment products and services. With net new brokerage account growth outpacing the industry and record net new assets, we feel good about our investments in sales and service, marketing, and product.

During the first quarter, we grew our sales force by 12% and our financial consultant team in particular by nearly 15% as we continue to emphasize engagement with long-term and retirement-oriented investors. During the first quarter we also kicked off our 2011 integrated marketing campaign, which builds on our past success while evolving to specifically target long-term and retirement investors. The campaign highlights our Investing Unleashed tagline and includes a mix of product focus ads, as well as two new spots released during the Super Bowl starring the iconic E*TRADE Baby.

We enhanced our Super Bowl investment where we reached more than 110 million viewers with significant free media opportunities where the E*TRADE brand and campaign were highlighted in social channels, as well as on highly rated shows including CBS and Fox Sports, Good Morning America, and the Today Show. We continue our disciplined test and learn process to ensure we maximize each sales and marketing interaction with customers and prospects.

During the quarter we also introduced a number of products and services to expand our offering. E*TRADE Capital Management launched the Unified Managed Account, building on the managed investment portfolios launched in 2010 and expanding our advisory offerings for customers seeking professional money management services. With a minimum investment of \$250,000 UMAs are customized portfolios that can include individual equities, mutual funds, and/or ETFs.

We launched E*TRADE Community, our next-generation social networking platform for investors. With more than 10,000 customers engaged during the beta period, E*TRADE Community leverages the explosion of social media, provides customers a platform to interact with other like-minded customers, and is an important channel for us to gather customer feedback. We are pleased with the response so far, and we'll continue to add features over the next several quarters.

Our ongoing investment in sales, service, and product complemented by a targeted advertising spend has been driving growth in key customer metrics, as well as sequential and year-on-year improvement in our brokerage account attrition rate. Our annualized customer attrition rate for the quarter was 9.9%, down from 10.3% in the fourth quarter and a significant improvement from 15.3% in the year-ago period. This improvement reflects a positive response from customers to simplified pricing and to the investments made in our sales and service model over the last year. By all measures, it was an outstanding quarter.

From here, I'll turn the call over to Matt to take you through the numbers in detail.

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

Thank you, Steve. During the quarter, we had net income of \$45 million or \$0.16 per share compared with a net loss of \$24 million or \$0.11 per share in the prior quarter and net loss of \$48 million or \$0.25 per share in the first quarter of 2010. We generated \$537 million in net revenue, up 4% from \$518 million in the fourth quarter, and even with revenues in the same period of 2010.

Our first quarter revenue included net interest income of \$310 million, up \$5 million from last quarter. This reflected a net interest spread of 2.84% on average interest earning assets of \$42.7 billion. We were pleased to maintain a relatively consistent net interest spread this quarter, though we expect continued downward pressure if interest rates remain at historic lows.

Commissions, fees and service charges, principal transactions, and other revenue in the first quarter were \$201 million, an increase of 11% from \$181 million in the fourth quarter. This increase was driven by an 18% increase in DARTs during the period. Average commission per trade during the first quarter declined slightly from the previous quarter from \$11.37 to \$11.32.

We are pleased that the action we took last year to simplify our pricing and eliminate a number of account fees has driven positive customer retention trends without materially affecting our average commission per trade. Our revenue this quarter also included \$26 million in net gains on loans and securities, including net impairment of \$6 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 quarter declined 2% or \$7 million from the prior quarter. Our expenses reflect increased advertising spend, both seasonal and strategic, which we believe continues to drive meaningful results in account and asset growth. As we indicated in our year-end call, we expect 2011 expenses to be roughly flat overall as we make strategic investments in sales, service, and marketing initiatives, while benefiting from a reduction in loan servicing costs, productivity-related savings, and lower restructuring expense. However, we do expect our FDIC insurance premiums to increase by approximately \$4 million per quarter beginning in the second quarter of 2011 as a result of the new FDIC rules which take effect in that same quarter.

Turning now to the metrics, DARTs for the first quarter were \$177,000, up 18% over last quarter and up 14% from a year ago. During the first quarter, net new brokerage accounts were 51,000, following healthy account growth in the fourth quarter when we added 28,000 net new accounts and up from 2,000 in the first quarter of 2010.

Net new brokerage assets were \$3.9 billion during the quarter, the highest we've ever recorded. This is an increase from \$2.4 billion in the fourth quarter and up from \$2.2 billion in the first quarter of 2010. Brokerage customer cash increased by \$1.4 billion to \$25.9 billion, while bank customer cash declined by \$200 million to \$8.8 billion. At the same time, customers were net buyers of \$2.3 billion of securities. In total, we experienced a net increase of \$1.2 billion of customer cash and deposits, which contributed to the increase in net interest income during the quarter.

Margin loans also made a positive contribution to our quarterly results, with average margin receivables growing 10% from \$4.9 billion to \$5.4 billion and up 38% compared to the same quarter in 2010.

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 \$900 million during the quarter. Net charge-offs declined for the seventh consecutive quarter, and delinquency trends continue to be favorable, exceeding our expectations during what is typically a seasonally soft quarter.

Related to loan modifications, the program continues to drive a meaningful reduction of losses, while allowing homeowners to remain in their homes. We've been quite pleased with the performance of the program to date, with 12-month average re-delinquency rates of 44% for home equity loans and 36% for one-to-four family loans, which compare favorably to industry averages.

Our loan loss provision was \$116 million, down from \$194 million in the fourth quarter and \$268 million in the first quarter of 2010. As you may recall, the provision in the fourth quarter included a \$60 million addition to our qualitative reserve that we do not expect to recur. In general, we expect these trends to continue, although performance is subject to variability in any given quarter. In particular, we expect the absolute size of the portfolio to decline at a rate of \$800 million per quarter in 2011.

Loan charge-offs declined by approximately \$2 million in the first quarter to \$194 million, and we were down from \$288 million compared with the first quarter of 2010. The allowance for loan losses at quarter end was approximately \$1 billion.

We were pleased that the bank generated \$149 million of regulatory risk-based capital and \$134 million of Tier 1 capital in the first quarter. As of March 31st, the Tier 1 capital ratio at the bank was 7.54% to total adjusted assets and 14.29% to risk-weighted assets. We ended the quarter with \$1.3 billion of risk-based total capital in excess of the level that our regulators define as well capitalized.

We continue to track consolidated ratios internally to prepare for requirements under the Dodd-Frank and Consumer Protection Act legislation. As of March 31st, the consolidated Tier 1 capital ratio was just under 4.5% to adjusted total average assets and just under 8.5% to risk-weighted assets. We expect these ratios will be above the well capitalized requirements in advance of the date at which we will be subject to these requirements.

We are also tracking our consolidated Tier 1 common ratio in anticipation of Basel III requirements. While uncertainty remains on how the regulators will implement Basel III, given the framework as it stands today, our estimated consolidated Tier 1 common ratio is 5.7%. We fully expect to meet the minimums each year as they are phased in through 2019.

We also ended the quarter with \$461 million in corporate cash, down slightly from \$471 million at the end of 2010.

To summarize, we are quite pleased with our solid start to the year and believe it positions us well for the balance of the year and beyond.

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

Steven J. Freiberg, Chief Executive Officer

Thank you, Matt. Before opening the call for questions, I would like to share a few additional comments. Again we are pleased with our start to the year. Our strong momentum and increased flexibility allow us to invest in sales and marketing initiatives that we believe will drive long-term customer, employee, and shareholder value. We continue to be optimistic that 2011 customer activity will be above that – what we experienced in 2010. The first quarter certainly reflected an engaged retail investor.

For current perspective, April month-to-date DARTs are down 5% when compared to March. At the same time, we continue to focus on priorities that enhance and drive customer engagement. E*TRADE retail branches hosted Retirement Evening earlier this month, welcoming customers and prospects to review diversification, higher options, and other retirement topics.

Next week more than 400 equity compensation leaders will attend E*TRADE Corporate Services Group's annual client conference, Directions 2011 for educational and networking opportunities. We are in the beta phase of My E*TRADE, which will provide personalization tools, allowing customers to make the E*TRADE experience uniquely their own.

We are working on a number of active trader enhancements for expected delivery throughout the year, including enhanced features in options, futures, and FX, as well as portfolio margining. We will continue to add to our already growing sales force, which we expect to increase by 35% in 2011. We will of course continue to focus on managing expenses while investing in these profitable growth opportunities.

So it has been a productive quarter, and we are proud of our accomplishments and at the same time remained focused on building on our momentum to drive the franchise forward.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Rich Repetto of Sandler O'Neill.

<Q – Richard Repetto>: Yes, good evening, guys.

<A – Steven J. Freiberg>: Hi, Rich.

<Q – Richard Repetto>: Yes, I guess the first question has to do with the strong metrics. It seemed pretty much the net new assets, brokerage cash, and margin loans, etc. So I'm trying to see what – the underlying driver. Do you think that's more just the environment? Or I know you spend – you're investing in the sales front-end-facing people, etc., but just a little bit more color on how you're producing the strong metrics.

<A – Steven J. Freiberg>: Yes, I think it's a composite of several. First and foremost, at least the one that I think is one of the best indicators of a consumer franchise happens to be, are you growing your customer base? And if you look at the trend over the last five quarters starting back in the first quarter of 2010, on a net basis, we had added 2,000 net new brokerage accounts. And we prioritized and focused throughout the year both on the marketing, the sales, the retention side of the franchise to improve substantially on that leading indicator.

And as Matt made the point, we got to 28,000 in the fourth quarter, and we pierced 50,000 in the first quarter, which actually now gives us, if you put it on a share metric, a higher share of net new brokerage accounts measured against certain players in the industry versus our overall market share. That's a very good place to be.

So I'd say it is smarter and higher spend to bring new customers in. At the same time, a much higher level of customer satisfaction, so fewer accounts are leaving us. And then in addition to that, the systemic environment really has been better in the first quarter of 2011 than it had been in the first quarter of 2010.

But if you look at the trend across '10 and then you look into basically 2011, it's beyond basically the market. It really is a sustained improvement quarter-after-quarter on getting the front end of the business into a much more productive place. And that has helped us drive not only clearly the accounts, but all the benefits that come along with that, like asset flows.

<Q – Richard Repetto>: Got it, got it. And then another question on the credit trend that – I saw home equity really improved just from February to March on the special mention loan bucket. But I guess my question is, did the reserve – you know, had big reserve release. Was in any part of that related to the modified loans and the qualitative reserve you took last quarter, and have we learned anything? I know it's only three months, but have we learned anything whether that \$60 million qualitative reserve was needed or not needed, given over three month – the three months more [indiscernible] (18:20) limited experience?

<A – Matthew J. Audette>: Hey, Rich, it's Matt. I'll take that. So with regard to the qualitative factor, it remained at 15%. But keep in mind that's a percentage, so it's percentage of a slightly smaller number. So it went from about \$90 million to about \$80 million during the quarter.

As far as what we learned in the quarter, I'd say it's consistent with what we said last quarter, which is we continue to be pleased with the performance in the modified portfolio. But it's still early days in having enough data to make a long-term view on where it's going. So I think we have another quarter that's consistent with that data from last quarter. So I think it'll be a long time before we would assess that 15% changing.

<A – Steven J. Freiberg>: Let me just add one qualifier so that we don't confuse folks on the line. We addressed \$60 million, which was the qualitative reserve. Prior to that we had a \$30 million qualitative reserve. So the reserve grew to \$90 million on a qualitative basis. And to Matt's point, it is now standing at approximately \$80 million because it's a relative function; it's not an absolute number.

<Q – Richard Repetto>: Got it, got it. And one last quick question -the gain on sale, you had – just on the \$30 million I believe that's – yes, and you – or excuse me \$32, and it's been in that \$40 million – I guess the question is the sustainability, how long can we continue to model \$30 million, \$40 million of gains coming through that line?

<A – Matthew J. Audette>: Hey, Rich, it's Matt. I'll take that one as well. So I think if you look back to 2009 and '10, there was certainly a fair bit of volatility, especially in the MBS market. And with \$16 billion of securities roughly on the portfolio, there was certainly some opportunity to take gains, you saw it during those years in the \$160 million range for the year.

Where we are today in 2011, that volatility has certainly come down. So our expectation is the trend is downward from those annualized numbers of \$160 million. But we couldn't really give you a very specific number other than we certainly expect it to come down.

<Q – Richard Repetto>: Got it, got it. Congrats on a strong quarter.

<A – Steven J. Freiberg>: Thanks, Rich.

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

<Q – Eric Bertrand>: Hi, guys. Thanks for taking my question. Some of your peers have been sharing with us some robust growth metrics in their mobile platforms and account usage. Can you provide some color as to the competitiveness of your platform and how much of your trade activity is coming from there and perhaps a profile of the typical mobile customer relative to your overall mix?

<A – Steven J. Freiberg>: Yes, we can just give you I think some color on what's going on. Obviously mobile has been and continues to be an area of rapid growth. And with the new devices coming online with sort of the proliferation of, I would say, smartphones and iPads, the probability and the absolute level of trading over those devices just continues to improve. But it's starting from a very low base.

And so right now the way we measure execution of DARTs, about 3% basically of our DARTs are really being executed via these devices. Although we believe, relative to a lot of our peers and competitors, we have probably the best experience over the device. The same experience that you would receive on your desktop, you are receiving on the vast majority of handheld devices that happen to be out there. And that's not the case for most of the industry.

But that said, the absolute number of DARTs being executed are relatively speaking modest, but growing. But our expectation is that, over both the intermediate and longer horizon, that these devices will become much more important not just only for information, but for execution. And so we're very focused on having a robust platform that covers a multitude of devices. And we think we've done a reasonably good job in representing ourselves in this space.

But it may not be intuitive. I think a lot of folks would have expected more activity over the devices, but we're still in the early stages.

<A – Michael J. Curcio>: Yes, this is Mike Curcio. Just to add an important data point, about 12% of our logins are now on mobile. So we do see a strong adoption trend.

<A – Steven J. Freiberg>: Yes.

<A – Michael J. Curcio>: And we get 100,000 unique logins a week on our mobile platforms.

<A – Steven J. Freiberg>: Yes, so going back to Mike's point, I think it's going to basically – it's moving through phases as the – basically the devices and the experience improves, which it has been. It basically becomes more or less a substitute over time for the interaction model. And we want to stay on the forefront of that.

<Q – Eric Bertrand>: Okay, shifting gears to the balance sheet of the brokerage, margin loan balances, as you said in the prepared remarks, grew nicely in the quarter, up 10% on average and 11% period-to-period. But we're seeing compression still in the net yield taking away much of the revenue upside. I'm presuming that that's a mix related to customers hitting lower pricing tiers. How much more of that do you think we could see over the next couple quarters as balances continue to grow?

<A – Michael J. Curcio>: So it's Mike Curcio again. It's definitely a mix issue. So what you're seeing is the highest balance accounts are growing quicker, so they have lower rates. And we're keeping an eye on it, but we don't see anything fundamentally shifting in the future. We think that trend will pretty much stay the same where we are today.

<Q – Eric Bertrand>: Okay thanks.

Operator: Next question comes from Michael Carrier of Deutsche Bank.

<Q – Michael Carrier>: Thanks, guys. Hey, just a question on – I think the growth in the new assets is obviously positive. And I just wanted to understand – if you can just walk through both the banking capital, or banking consolidated capital needs, the net new assets, the growth continues and the positive growth is somewhere in that \$1 billion, \$1.5 billion, and then the offset of – as – the longer that you make earnings and you had the DTA benefit, like how much that can benefit and offset that.

<A – Matthew J. Audette>: Sure, this Matt. So as far as capital growth, I think if you see this quarter, we grew capital at the bank on all ratios. For the Tier 1 at a leveraged ratio, we're at 7.5% and for the risk-based ratio at 15.5%. And we grew total assets this quarter. So as we return to profitability like we have, it's helpful, and that actually funds the growth. So we don't see any issues, as customer cash grows over time, being able to fund that from a capital perspective.

And your second – I'm sorry, your second question was?

<Q – Michael Carrier>: Yes, it would just be on the consolidated side to – meaning how much can be allocated to the consolidated relative to the bank?

<A – Matthew J. Audette>: Sure, so up-streaming capital from the bank to the parent?

<Q – Michael Carrier>: Right.

<A – Matthew J. Audette>: Sure, so on those ratios I said in dollars, all three of those ratios are in excess of \$1 billion even on our most constraining ratio. And it's certainly important to us to maximize the return on that capital for our shareholders. So it'd be our preference to move that up to the parent.

However, as I'm sure you know, we're a regulated entity. We would need regulatory approval to do so. We really couldn't speculate on whether our regulators would be able to approve that or not,

especially in a period where we're transitioning from being regulated by the OTS and to a combination of the OCC and the Fed.

But I will tell you from our perspective, generating consistent profitability, continuing to generate the metrics like Steve and I went through in the prepared remarks, as well as continued improvements in credit, from our perspective, we think that would help improve our chances in having capital upstream to the other bank. But we certainly couldn't confirm whether the regulators would view it the same way. But that's certainly our perspective – that it helps.

<Q – Michael Carrier>: Okay. And then just as a follow-up, I think you mentioned in terms of the loan book about an \$800 million run-off per quarter. And correct me if I misheard that. And then just given the growth in the deposits, like from a balance sheet standpoint, now we're at like \$42 plus billion, just what we would be expecting growth from here, and then just in terms of the NIM, any other roll-off versus the new investments where the yields are, just so we can gauge where that NIM should be falling over the next couple quarters.

<A – Matthew J. Audette>: So as far as balance sheet growth, I don't have a specific number other than we think that the growth will be driven by the growth in customer cash. So we've been fairly consistent in growing that each quarter in the \$1 billion to \$1.5 billion range. We would expect that – I wouldn't be surprised – I'll be quite pleased if that continued.

With regards to spread, I think in the prepared remarks we commented on the spread at the quarter was 2.84%. And given the current interest rate environment and the very low absolute level of rates, there's certainly going to be a pressure to maintain that going forward, meaning if nothing else changes, that could come down slightly going forward.

<Q – Michael Carrier>: Okay, thanks a lot.

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

<Q – Patrick O'Shaughnessy>: Hey, good afternoon, guys.

<A – Steven J. Freiberg>: Hi, Pat.

<Q – Patrick O'Shaughnessy>: Hi, I think I'm going to have to keep talking here, Matt. And just to follow up on that last question, so can you help provide some sort of scale of what coming down slightly on that spread means? So for example, earlier today Schwab has this business update. They say, hey, their net interest margin might fall by around 10 basis points over the duration of the year. Are you able to put some similar sizing on what you expect?

<A – Matthew J. Audette>: Well, I wouldn't put a quantitative sizing on it. But qualitatively if you look at the decline during the quarter, which was four basis points, I don't think you'd be woefully inaccurate if you extrapolated off of that.

<Q – Patrick O'Shaughnessy>: All right, that's fair. And then for my follow-up question, we recently saw Schwab announced it's going to be buying optionsXpress. Couple of years ago TD Ameritrade bought Thinkorswim. How do you view your options trading capability as stacking up against those guys, especially given that you have not been active on the acquisition front recently?

<A – Michael J. Curcio>: Hi, this is Mike Curcio. Yes, we keep close eyes on our competitors obviously. And we feel our option experience stacks up well. We've made a lot of advancements over the last couple of years. Our option business has grown nicely. It's about 19% to 20% of DARTs on a given quarter. We rolled out advanced options on our pro product. We have advanced screeners and scanners coming in later this year, and integrating futures on our core product by the

end of the year, plus FX which we're working on. So we think we'll be well represented, and we feel we have very good user experience, and our clients do as well.

<Q – Patrick O'Shaughnessy>: Great, thank you very much.

Operator: Next question comes from Daniel Harris of Goldman Sachs.

<Q – Daniel Harris>: Hi, good afternoon, guys.

<A – Steven J. Freiberg>: Hi, Dan.

<Q – Daniel Harris>: Hey, I was wondering if you could touch on the expense side of the business here. On the one hand, numbers continue to come down. We're starting to see some stabilization in the comp over the last few quarters in the trading and investment line. Non-comp looks like you guys are still very focused on that. But how you see that projecting over the next few quarters?

<A – Matthew J. Audette>: Sure, this is Matt. So expenses were \$298 million for the quarter. We commented on the year-end call that a decent run rate going forward would be around \$290 million. And what we saw in the first quarter, we're still comfortable with that run rate. A few things to highlight though for the quarter – first seasonality, both comp and benefits, as well as our marketing, Q1's typically the highest quarter of the year. So seasonality going forward will have those items likely decline. And second, in the restructuring charge line, we had \$3.5 million of restructuring charges. We had no new real activities during the quarter. We just had some finalization of activities from 2010. And the actual cost came in a little bit higher than we estimated. So when you remove all those items, the \$290 million run rate we're quite comfortable with going forward.

<Q – Daniel Harris>: Okay, shifting over to the market making business, you guys had a nice uptick in volumes in the quarter; drove principal transactions almost \$30 million. I know this has been areas that you guys have been focusing. On two things – first of all, with Citigroup going through its reverse split, was interested in how you think that impacts your business. And second of all, other means of organic growth there would be – I'd love to hear your views.

<A – Michael J. Curcio>: Yes, it's Mike Curcio again. So on the first one, the Citi is one of the most popular traded stock. So that'll have some effect. But we see pickup in our international business, our ADR business.

And in the market making specifically, we did have a great quarter. In fact, it was the best quarter since E*TRADE purchased Dempsey, and you'd have to go back to 2001. And what we're seeing is increased OTC trades that are automated, which is helping profitability. And most importantly the external NMS volume increased from January to March 31st from 36% to 40%.

So we're doing a really good job as we come out of our crisis, or as we came out of our crisis, excuse me, of really bringing business back and bringing a lot more new business in. So it's a really good story, and we'll continue to stay on that path.

<Q – Daniel Harris>: And do you think that the rate that you're generating, the basis points per value traded or per share, should stay relatively constant, or do you see any way with new algos that that actually could move higher?

<A – Michael J. Curcio>: I think it'll be – we're always trying to get it higher, but I think it'll be – remain constant.

<Q – Daniel Harris>: Okay. And then lastly, a quarter in, you guys have been able to direct your flow post the deal that you guys had in place for the last few years. Any impact there, and how should – how did it impact your numbers this quarter? Thanks a lot.

<A – Michael J. Curcio>: Good question. We have seen that's also helped in the market making. So we're internalizing more of our own order flow, but not the whole amount. So we still leverage a lot of market makers, and we also have unique ways to leverage our retail flow, as well as our institutional flow. So we'll continue down that path for maximum profitability.

<Q – Daniel Harris>: Thank you.

<A – Michael J. Curcio>: Yes.

Operator: Next question comes from Mike Tarkan of FBR.

<Q – Michael Tarkan>: Hey, guys, a couple of quick questions for you. Can you walk us through your decision to sell Kobren Insight during the quarter and then maybe touch on what you're seeing in the RIA channel overall?

<A – Michael J. Curcio>: It's Mike Curcio. So our decision to exit the RIA business was made a few years ago. And really when you think about it, we had a roll-up strategy. And right when we were starting to execute against that strategy, we had our crisis. So we decided to sell off the properties, and Kobren was the last one.

So now we're clean with respect to running an RIA business. But what we have done is we've partnered with Lockwood. We have managed investment portfolios, as well as the UMA, which Steve talked about before, for our retail customers. And if small advisors like our platform, we have the service capability to service them correctly.

<A – Steven J. Freiberg>: Yes, just to add on that, so we're out of what I would call the owned RIA business. We do have several hundred independents who run through our platform. And in a world where prioritization is important, we had a set of strategic priorities for 2010 when I arrived in 2011. And even though it's an important base and constituency, it didn't rise to the most important of what we had to execute for '10 and '11.

But we will reevaluate not so much the owned RIA model, but the ability to support those kinds of businesses off our platform. But we do have a basis in, I said, several hundred of those folks that operate through us. But what you have seen is the residual tail of a business that was started several years back and then ultimately we did exit.

<Q – Michael Tarkan>: Okay, thanks for the color. And then I guess in terms of account attrition, can you just give us a little more color on your investments there?

<A – Michael J. Curcio>: It's Mike Curcio again. So we've been – it's really a combination of everything. It's our technology, operations, service, marketing and messaging, and product. And we're really maniacally focused of fixing the customer pain points in an automatic or automated fashion. So we've actually reduced the number of customer service folks and reduced them out of customer service comp, while we've increased customer satisfaction. And that will continue because it's a focus throughout the firm.

<A – Steven J. Freiberg>: But, yes, I'll just add one additional point from the standpoint of – customer satisfaction is materially higher over the last 24 months. So this was started – this was not so much episodic. This is in the fabric of the Company as we stand.

And simplistically or oversimplifying it, a lot of diagnostics have been done on what the dis-satisfiers are, and they've been warped by the ones across the period. And clearly they've had profound impact on the business including, as we addressed during the more prepared commentary, essentially the alignment of certain of our fee structures and pricing.

But if you think about it, we've seen in a 12-month period attrition drop by 500 basis points from 15 to something under 10. Roughly 40% of that we would attribute to pricing-related. But 60% of that would be attributed to non-pricing-related, where the customer experience is materially better, and the customers feel then materially better about being customers of this Company. And we're going to continue strive to drive the number as low as we can, particularly with the customers that are so important to this franchise.

It's very expensive to add a new customer, and it's very unfortunate when we lose a good customer. So we're losing many fewer good customers today. And that's allowing us to show 50,000-plus net new brokerage accounts in a quarter. And we haven't seen numbers like that in a long, long time. In fact, I would argue we haven't seen numbers like that almost ever if you also qualify it by the quality of the customers coming in. So these are not shallow or hollow accounts. These are actually very good accounts as well, as we measure the quality of what's coming through the system.

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

Operator: Next question comes from Joel Jeffrey of KBW.

<Q – Joel Jeffrey>: Good afternoon. guys.

<A – Steven J. Freiberg>: Hi, Joel.

<Q – Joel Jeffrey>: Just a quick question – the book value looked like it declined during the quarter. Was that primarily – was that essentially just to due to Citadel's conversion?

<A – Matthew J. Audette>: So the book value of the Company?

<Q – Joel Jeffrey>: Yes.

<A – Matthew J. Audette>: Yes, so the book value of the overall Company increased. I think you might be talking about the book value per share.

<Q – Joel Jeffrey>: Yes, I apologize.

<A – Matthew J. Audette>: Yes, so the book value per share, keep in mind when we have conversions everything is effectively issuing equity at around \$10 per share. So if you look at the Q1 or the year-end numbers, the book value per share was around \$18. So with the conversions during Q1, we issued new equity at \$10 a share. If you look just below that, the tangible book value actually has the opposite effect. And at the year-end tangible book value per share was \$9. So it was accretive, and that increased as we issued equity at \$10 a share. So it's solely that.

<A – Steven J. Freiberg>: Yes.

<Q – Joel Jeffrey>: Okay great. And then just going through the 10-Q, I mean, back in February it looks like you guys were issued a Wells notice on your auction rate security or your client's auction rate securities. Is there any update on that, and has the amount of client auction rate securities outstanding declined from that \$138 million?

<A – Karl A. Roessner>: It's Karl Roessner. At the end of March, so March 31st, we were at about \$125 million in auction rates in customer accounts. And with respect to the Wells notice, we're obviously cooperating, and we don't really talk about or get into the substance of our regulatory matters.

<Q – Joel Jeffrey>: Okay, fair enough. And then just lastly, can you give us a sense for how DARTs to date in April are tracking?

<A – Steven J. Freiberg>: Yes, we made the point in the prepared comments. But to date they're approximately down 5% as compared to March.

<Q – Joel Jeffrey>: Great, thanks again.

Operator: Next question comes from Brian Bedell of ISI.

<Q – Brian Bedell>: Hi, good evening, guys.

<A – Steven J. Freiberg>: Good evening.

<Q – Brian Bedell>: Can you just talk a little bit about your expense philosophy if we get either a weaker revenue environment, i.e., lower trading, how much flexibility you have to reduce expenses?

And then I guess on the other side of that, if you're seeing account growth be particularly strong and your advertising per account pointing to pretty good metrics, would you actually raise your advertising to a significant degree to the extent that you'd be over your \$290 million per quarter average on expenses?

<A – Matthew J. Audette>: I'll take the first, and I'm sure Steve will take the second.

<A – Steven J. Freiberg>: Sure.

<A – Matthew J. Audette>: So with regard to expenses going forward, I think in that hypothetical, absolutely. If trading drops dramatically, I think any company would look at where and how they should cut their expenses. But where we are today, I think the philosophy is as we've said a few times, which is overall to manage expenses flat, but be able to reduce expenses in non-customer-facing areas to be able to reinvest in the customer-facing areas.

<A – Steven J. Freiberg>: Yes, and just going back, we really have instituted a fairly disciplined or a very disciplined approach to how we prioritize, manage, spend our resources. And I think to the point, just using marketing as one example, most of our marketing spend does run through a fairly objective set of models that are looking at whether or not we're getting a fair return on our investment. And not unexpected, when the market is more robust, you get the systemic improvement as more people are interested in the category. And as markets become less robust, you sort of get the negative halo coming through. And we do feed it through models. So you will see some flex on marketing spend depending upon the environment in which we're operating.

Then in addition to that, there is a significant amount of our costs that are variable with volume. So they'll flex up, and they'll flex down as well. But to Matt's point, we believe if you look over the last four quarters or so, at least it's been the time I've been associated with the Company, what we're trying to do is to drive margins up, drive shareholder value up, be smarter about how we deploy our resources, be much more focused, get out of the hobbies business, and really drive franchise value and franchise growth.

So in any given quarter, there may be some volatility. But I don't think the band around that volatility is going to be significantly large. And if in fact we flex higher or lower, we get a very direct dialogue with you folks as to what we've done and why we've done it.

But as things stand today, we think we're managing our resources in a more effective way at a reduced level, and that's what we're striving to do. But if in fact we can drive business faster and higher at good economics, we'll make good business decisions, but we're not just going to spend money because it's a good thing to do. We're going to spend money because it's the right thing to do.

<Q – Brian Bedell>: Right. So it sounds like if you're really generating great account growth yet the DART environment is weak, you'll still spend on advertising. Then you'll have other levers to flex on the variable expense side.

<A – Steven J. Freiberg>: Yes, and what's also happening, although it's going to be over a longer period of time, if you think about it, the way we earn or the way we generate revenue and earn money, part of it is the balance sheet, as been discussed. And customer cash drives it. So even if there's some subdued trading activity, the customers leave today \$30-some-odd billion dollars with us at relatively low cost to us; clearly low yield to them. But we take that as an opportunity, and that gives us more stability.

What we're really keen on though is to expand our relationship to do the trading with our customers, but also to help serve their investing needs. And Mike and others in the teams have been very focused on that, and a lot of the sales folks that we're adding, who have the financial consultant's experience, people who come out of environments where they help people manage money, we think that'll give us a more actuarial view than just a transactional view of the value of our customer.

Also I think from an essentially contextual standpoint, our customers today have about \$190 billion of their financial assets with us, but they have roughly \$2 trillion of financial assets overall. And we want to expand relationships with those folks by basically marketing, which is positioning; by the sales force, which really is in fact help that these folks really require and need; and product, which is about essentially execution.

And we continue to invest across all three fronts with an expectation that we are slowly but surely reshaping the business model as well – not forgetting that essentially our heritage and our hallmark is trading. And we want more DARTs all the time, but we also want to help provide a more robust sort of services and activities to our client base. And we're seeing progress there. But again that's an over-time commentary. That's not going to happen spontaneously no matter what.

<Q – Brian Bedell>: Right, and then that \$190 billion and \$2 trillion figures you threw out there, should I assume that's close to a 10% wallet share, or is that not a...

<A – Steven J. Freiberg>: It's precisely within that range. And as you would expect, because we have I think fairly good segmentation models as well, that wealthier our client, the smaller the wallet share and the less wealthy the client, the larger the wallet share. But the average is more less in that ballpark that you described. So if you're an optimist, you'd say extraordinary opportunity. And if you're a pessimist, you'd say look how far behind we are. I tend to be the optimist.

<Q – Brian Bedell>: Right, right. No, definitely. And then just how far along you are on the 35% sales force growth?

<A – Steven J. Freiberg>: We're tracking precisely to basically what we modeled and what we budgeted.

<Q – Brian Bedell>: Right. So you're like a fourth of the way through that, or have you hired more than...?

<A – Steven J. Freiberg>: No, roughly – basically if you take the 3%5 we're about a third of the way through it.

<Q – Brian Bedell>: A third of the way through. Okay, great, thank you.

<A – Steven J. Freiberg>: And we're very – and actually just to add, and we're very happy, very pleased with the quality of the people coming through because just hiring numbers, as we all know, won't add very much. But it really is getting the quality and the quantity. And so far we feel very good about the quality of the person coming into the firm.

<Q – Brian Bedell>: Great, thanks so much.

Operator: Next question comes from Faye Elliott of Bank of America.

<Q – Faye Elliott>: Hi, thanks. Could you touch on the mix shift of costs going forward in light of your plans to continue building out the sales force? Especially in light of the higher FDIC assessment, can you just comment on where – which lines should come in?

<A – Matthew J. Audette>: Sure, Faye, this is Matt. So as far as the mix shift, there won't be a dramatic mix shift other than seasonal items that I highlighted, which is comp and ben typically is high in Q1 and then comes down, as well as advertising is high in Q1 and comes down.

Specific to the FDIC, it's actually its own line item on the income statement. So the increase, which we expect to be around \$4 million per quarter, will show up right in that line item.

And as far as the sales force, I'll turn that back over to you.

<A – Steven J. Freiberg>: Yes, and I think what – and this is the comment on the evolving firm. Several things are changing, and I think for the positive. One, given the last three years, a lot of cost and focus really has been absorbed by the legacy asset. And as the legacy asset becomes less significant and less impactful, it gives us more degrees of freedom on how to redeploy resources, both economic resources, as well as people resources to invest in more productive areas.

Obviously it's an area that we're not going to ignore. It is still substantial, and it's still a challenge. But we believe we're on a very positive track, both in absolute size and relative impact. But if you think about the firm over the next several years, that aspect of what we do today, which is managing still a \$15 billion legacy portfolio, becomes less necessary just by virtue of time and management.

And now the question is, those resources that get freed up – and they're not insignificant – how do you redeploy them in a much more productive way, not to similar to what this company has done over the last several years in other areas? So basically it's not so much evolution as it is thinking about strategy and thinking about priorities and thinking about where you've spent and where you could spend to really grow the franchise in a productive way that drives shareholder value.

So we have – and we don't have the time, but we have several areas that have similar characteristics that, as we think out over the horizon, actually should allow us to better deploy resources, that really drives profitability and growth versus just protection.

<Q – Faye Elliott>: Got it. So as operations improve, say, on the bank side, you can redeploy that spend on the brokerage side.

<A – Steven J. Freiberg>: Clearly that is probably one of the best examples of where opportunity is likely to be derived from over time.

<Q – Faye Elliott>: Okay, great. And then real quick, can you comment on the percent of transactions that were derivatives-related?

<A – Steven J. Freiberg>: Yes, we can give you that number. Who has it handy? Yes, given options run at about 18% to 19% and if you want to add to that futures run about 2% – and those I would basically kind of cull out as our derivatives. So let's say that that if you add up the numbers today, probably around 21% of the trades in the quarter were derivatives of some form, either in options or futures.

<Q – Faye Elliott>: And is that a steady run rate over the quarters, or is that -

<A – Steven J. Freiberg>: It's been basically stable sequentially, but it's actually up if you look back one year ago where it was probably closer to about 17%. And to Mike's point earlier, we're focused basically on enhancing our capabilities, both for options, futures, and out over the horizon things like FX as well.

So I'd say that we believe, one, it's a very profitable business many of our customers utilize, as evidenced by the percentages. And we think we can actually enhance the experience in these categories and add to the categories out across the remainder of 2011. So we're not talking about future-future but we are talking basically feathering this in over the next coming quarters.

<Q – Faye Elliott>: Okay, great. Thanks for the color.

<A – Steven J. Freiberg>: All right, Faye, thank you.

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

<Q – Howard Chen>: Hi, good afternoon.

<A – Steven J. Freiberg>: Hi Howard.

<Q – Howard Chen>: Thanks for squeezing me in. On your Basel III guidance, I just wanted to confirm that that 5.7% is a consolidated figure. And if so, could you just give us some of the underlying assumptions to walk from that 8.5% Basel I that you're at now to 5.7% Basel III?

<A – Matthew J. Audette>: Sure, so this is Matt. So I think it is consolidated. Our most constraining ratio when you look at all the ratios under Basel III is the Tier 1 common. So that's the one that we've highlighted. And at the end of the quarter, that is at 5.7%. It was up from 4.2% in the prior quarter. And as Basel III is phased in on that ratio from 3.5% to 7% from 2013 to 2019, we're comfortable that we'll meet those minimums well in advance each and every year. So those are the primary components.

<Q – Howard Chen>: Okay, but I guess could you give us any flavor for like the numerator and denominator in terms of like risk-weighted assets or adjustments that you're making?

<A – Susan Hickey>: [indiscernible] (52:36).

<A – Matthew J. Audette>: I'm sorry. Can you repeat that?

<Q – Howard Chen>: I was just wondering, some of the underlying assumptions of like the numerator and the denominator and deductions that – or mitigating actions that you've been taking, is there any other kind of color that you can add onto that?

<A – Matthew J. Audette>: No other color other than over the long term you could expect the DTA, which is at about \$1.5 billion today, is going to be a strong driver over that long period of time of improving the ratio.

<Q – Howard Chen>: Okay, thanks, Matt. And then switching gears, sorry if I missed this so far, but just could you update us on your overall outlook for provision expense and maybe pace of reserve draw-down from here as you continue to burn down the legacy book?

<A – Steven J. Freiberg>: Yes, this is Steve. I'm going to – Paul has been waiting to answer...

<A – Paul Brandow>: No, I just [indiscernible] (53:22).

<A – Steven J. Freiberg>: ...at least one question, and so you've given him an opportunity. All right, Paul.

<A – Paul Brandow>: Great. So I hate to disappoint everybody, but I'll give you my sort of normal answer. As you know that our – for our non-modified loans, the allowance represents our forward-looking loss estimate for the next 12 months. And so you can see that from our – in our press release and for TDR as our modified portfolio, it represents a life of loan forecast.

You pointed out, of course, there is a gap between the reserve release and the charge off this number this quarter. But as I would point out, the charge-off is really reflecting the losses that are sort of baked into the portfolio for some time now, whereas the provision really reflects what we think is going – what the scenario is going forward. And that scenario is affected by many things, but most of all by delinquencies. And as you've seen in our delinquency reports for this quarter, that we had quite a good quarter, and in fact that it was better than most of our forecast had expected. So that sort of colors our forward outlook.

<Q – Howard Chen>: Okay, thanks. And then final one from me, last quarter I think you spoke to a normalize 3% NIM. And I was just hoping to get a sense of what you deem to be kind of a normalized environment, whether would be where Fed funds is at and shape of the yield curve. Thanks.

<A – Matthew J. Audette>: Sure, this is Matt. So we did speak about the 300 basis points. And just to confirm, that is a long-term view in a more normalized interest rate environment. And we continue to be comfortable with that, driven primarily by the large amount customer cash that we have.

Where we sit today, though, in the current interest rate environment and our spread for the current quarter at 2.84%, in this current environment, we certainly expect pressure on that spread going forward, assuming rates stay where they are. So that's it.

<Q – Howard Chen>: Okay, thanks much.

Steven J. Freiberg, Chief Executive Officer

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

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

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2011. CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.