
MANAGEMENT DISCUSSION SECTION

Operator: Welcome to E*TRADE Financial Corporation's third quarter 2006 earnings conference call. At this time, all participants have been placed on a listen-only mode. Following the presentation the floor will be open for questions.

I've been asked to begin this call with the following Safe Harbor statement. During this conference call, the company will be sharing with you certain projections or other forward looking statements regarding future events or its future performance. E*TRADE Financial cautions you that certain factors including risks and uncertainties referred to in the 10-Ks, 10-Qs, and other reports it periodically 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.

The call will present information as of October 18, 2006. Please note that the company disclaims any duty to update any forward looking statements made in the presentation. In this call, E*TRADE Financial may also discuss some non-GAAP measures in talking about its performance and you can find the reconciliation of those measures to GAAP in the company's press release which can be found on its website at www.etrade.com.

This call is being recorded. Replays of this call will be available via phone, webcast, and by podcast beginning at approximately 7pm eastern time today through 11pm eastern time on Wednesday, November 1. The call is being webcast live at www.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

I'll now turn the call over to Mitchell Caplan, Chief Executive Officer of E*TRADE Financial Corporation; who is joined by Jarrett Lilien, President and Chief Operating Officer; and Robert Simmons, Chief Financial Officer. Mr. Caplan?

Mitchell H. Caplan, Chief Executive Officer

Thanks everyone for joining us today. This past quarter, E*TRADE Financial celebrated ten years as a public company. In 1996, we were a mono-line – online brokerage company that had 91,000 accounts and annual revenues of \$52 million. Today we have matured into a diversified financial services institution with over 4.4 million global retail customer accounts and annual revenues of approximately \$2.5 billion.

From transforming the way people traded stocks a decade ago to helping redefine the broader financial services sector today, E*TRADE has emerged as an integrated global growth franchise that provides a distinctive suite of financial solutions to the value focused investor. Having built our entire model around an integrated low cost infrastructure, we are in a unique position to deliver the mass affluent investing customer a compelling value proposition across price and functionality and service. Our third quarter results illustrate the power of our transformed model and demonstrate that the strategy of engaging with new and existing customers across multiple products serves both as a bridge over seasonality and as an avenue for future organic growth.

I am pleased to report that we generated earnings of \$0.36 per share excluding acquisition related integration expenses and \$0.35 on a GAAP basis. Included in these earnings are a number of unusual items creating some noise in our results but which net to approximately zero in the aggregate. In a few minutes, Rob will discuss these items in detail.

More importantly, however, embedded in these results is the success of our execution. By offering customers the right products for the current environment, we grew our enterprise cash balances by \$1.5 billion last quarter, our second highest level of cash growth ever. That increase allowed us to grow our balance sheet to a record \$46.4 billion in average interest-earning assets. Those assets

generated a record \$343 million in net operating interest income after provision, up \$8 million sequentially. This increase helped to offset the anticipated decrease in retail trading commission revenue. While we always expect that certain trading activities will slow during the summer, the high quality recurring revenues generated by the spread on our growing customer cash and credit balances helped produce the strongest third quarter results in the company's history.

In reflecting on our competitive position, we believe we are at an inflection point for both accelerated growth and earnings expansion as we invest in building a long term franchise. As we have said in the past, during the 2003 to 2004 timeframe, we built a technology infrastructure to support a highly integrated product offering and global operations. That integrated infrastructure has two significant benefits. First, it allows us to view our customer relationships on a holistic basis and manage the business accordingly. Second, it allows us to deliver the appropriate products and services more efficiently and in the process, generate higher incremental operating margins on each additional dollar of revenue.

By way of example, the E*TRADE Complete investment account accomplishes exactly this, by offering high value integrated financial solutions across trading, investing, banking, and lending. The result has been broader customer engagement across all of our products, most notably evidenced in the organic enterprise cash growth of over \$5 billion in the five quarters since the launch of Complete, fueling efficient balance sheet growth. During that period, net operating interest income after provision grew 75% and now represents almost 60% of our total net revenues. We are now positioned to expand our fee based revenue contributors and broaden our geographic footprint with that full suite of products.

By investing in these areas, we enhance our opportunity for organic growth domestically and extend our reach globally. As our competitors have largely abandoned their ambitions outside of the US, our international success also represents a key differentiator. As we look at the size of the potential global market, we have identified a universe of nearly 80 million mass affluent households holding over 11 trillion dollars of investable assets.

In viewing our international prospects, we will continue to develop and distribute products and services based on a compelling value proposition comprised of the three pillars of price, functionality, and service. We plan to move forward thoughtfully but aggressively on this expansion as evidenced by our recent efforts to increase our holdings in IL&FS Investsmart in India. This move opens the door to expand our operational partnership in that region which we believe is crucial in navigating cultural and business differences. This partnership, through which we plan to provide local Indian investors access to both domestic and international markets and global customers with opportunities to invest in one of the world's most rapidly expanding economies, will serve as a prototype for continued expansion in other developing economies.

Our continued successful execution demonstrates that a model which delivers relevant financial-driven, value-driven solutions to investing customers is a model that will thrive in a variety of macroeconomic conditions. More importantly, we believe the continued customer engagement that we are experiencing confirms that our value-based products and our low cost delivery channel are at an inflection point as we expand our geographic footprint. As we move forward and celebrate more anniversaries, we will continue on our mission to deliver value to our shareholders by building on our successes and delivering timely value to our global investing focused retail customer.

Now to provide further detail on how the quarter unfolded, I'd like to turn the call over to Jarrett.

R. Jarrett Lilien, President and Chief Operating Officer

Thanks, Mitch. By deepening engagement with our existing global retail base and attracting new, high-quality customers, we have created a franchise that delivers strong results. Across our

trading, investing, banking, and lending solutions, we continue to see strong overall growth trends signaling that our value proposition continues to resonate. Net revenue and net income were up 39 and 43% respectively year over year as a result of both organic growth in our target customer segments and successful integration of Harris and Brown.

While the annualized growth rate of customer accounts in a retail business is trending at about 5%, the annualized growth rate of our high value targeted segments is growing at about 30%. As a result, we continue to see increases in the quality of our overall customer base. Assets per customer, revenue per customer, segment income per customer, and products per customer have all improved significantly.

Moving to our balance sheet, average interest-earning assets increased by \$2.3 billion or about 5% sequentially. Net operating interest income after provision grew 2.5% sequentially and was up 68% versus the year ago period, fueled by growth in customer cash and credit.

Our net interest spread decreased a modest five basis points to 286 basis points. This is within the range of our guidance for the second half of the year and well below compression levels seen by others in the industry. As we discussed last quarter, we believed that there was an opportunity to deepen customer engagement and attract new high quality global customers by offering relevant value based cash solutions. Important to our model, we believed that from a rate/volume perspective, the investment of a few basis points of spread to fund a larger interest-earning asset base would pay off, and it did. As Mitch noted, total enterprise cash increased by \$1.5 billion this quarter.

But there's a more interesting story here. 72% of new deposit account openings and 80% of new account balances came from current investing customers. Nearly all of these investing customers increased their total assets with us and almost half increased their total assets by over 20%.

Even more compelling, the value of these customers was evident not only in the increased asset levels but also in the significant outperformance in trading, option volumes, commission revenue, and margin balances as compared to the broader customer base. Accordingly, we were able to not only grow net operating interest income but to deepen relationships and engage new target customers, providing both current and future financial benefits.

In the quarter, while average margin debt balances declined 5% as customers delevered, average mortgage and home equity loan balances increased 16%. Importantly, as we continue to build out our asset origination capability, we saw a 5% increase in retail mortgage related lending originations and a 34% increase in those balances that we kept on our balance sheet. As always, we continue to adhere to our strict and conservative credit policy – philosophy.

In trading, September DARTs [Daily Average Revenue Trades] increased 10% versus August as we exited a period of seasonal softness and the market regained momentum. Overall, third quarter DARTs declined 18% versus the second quarter but were up 44% versus the third quarter of 2005, driven in large part by the successful integration of Harris and Brown. Anecdotally, the Harris and Brown customer trading activity suffered less of a seasonal decline than the broader customer base. Further for those customers, assets are up 6.5% and we have crossed \$1.1 billion in deposit balances since closing. This performance shows the increased value of these customers as we originally modeled no cross-sell benefit.

Finally, we have achieved 102% of the original expense synergies as we exited the third quarter.

Within our trading solutions, options continue to be a growth area for us and now comprise 13% of domestic trading volumes. Looking abroad, while international DARTs were seasonally down 19% sequentially, they were up 28% year over year, an increase resulting entirely from organic growth as we have yet to engage in any international consolidation.

Retail average commission per trade decreased from \$12.23 in the second quarter to \$11.95. This decrease was a function of the mix of customers as Main Street customers traded less during the period which resulted in a heavier weighting of active trader commissions. Given the seasonal pickup in the fourth quarter and the trends we saw in the month of September, we would expect to see average commissions return to a level over \$12.

During the quarter E*TRADE, like a number of our competitors, experienced a significant increase in losses resulting from fraud relating to identity theft. This has recently been highlighted by the media and has become a focus of the SEC and other regulatory agencies. In the quarter, this resulted in an \$18 million increase in fraud losses.

As always, we continue to stand by our customers through our Complete Protection Guarantee. While our systems remain safe and secure, we continue to take steps to deter unauthorized activity in our customers' accounts and believe we have made appropriate technological and operational changes to significantly reduce the potential impact of these matters on an ongoing basis. We are working diligently with others in the industry, regulators, and law enforcement officials to make appropriate changes and are confident that these combined efforts will help reduce this fraud.

Across our retail offerings, our investment in service has taken a firm hold throughout our business. We continue to invest in people and process to improve customer satisfaction. As a part of this effort, we have integrated our customer service, migrating to the former Harris and Brown customer service platforms and significantly increased the number of employees answering our customers' needs. As proof points of the success of this service expansion, we have reduced average speeds of answer to less than 40 seconds generally and to less than 30 seconds for our target customers. Further, we've achieved an abandonment rate of 4% overall and 3% for our targeted segment.

Continuing the theme of organizational integration, we are confident we will soon obtain final written approval to move our clearing business under the Bank. While this process has taken longer than expected, we have met all of the conditions for bank regulatory approval and anticipate receiving written approval within weeks. This approval will let us move forward with the final phases of our structural balance sheet integration. Again the benefits of this structural change are threefold: one, more efficient capital allocation; two, a lower cost of funding as we leverage brokerage cash to fund balance sheet growth; [three] and lower hedging costs as we optimize the duration characteristics of the brokerage assets and liabilities.

Once this new structure is finally implemented, we anticipate operational and economic efficiencies that will drive further opportunity for margin expansion, particularly once the yield curve returns to a more normalized slope. The specific future benefits to the model will be included in our 2007 guidance discussion in December.

So as you can see, the third quarter was a strong one for us from both a quantitative and qualitative standpoint. The model continues to resonate with customers, driving compelling growth and profitability.

And with that, I'll turn the call over to Rob for the financial details of our results.

Robert J. Simmons, Chief Financial Officer

Okay, thanks Jarrett. During the quarter, our efforts in developing a model less affected by volatility in the markets really paid off. Let me walk you through a few of the highlights.

Third quarter net revenue decreased 5% sequentially on retail commission seasonality but increased 39% against the comparable year ago period. Net operating interest income after

provision increased \$8 million sequentially to a record \$343 million, growing 68% year over year. As Jarrett noted, the increase in net operating interest income was the result of a larger balance sheet while net interest spread declined modestly in a calculated effort to attract and deepen customer relationships.

We will continue this calculated rate/volume approach, taking into account our success in new and existing customer engagement. We believe this will allow us to generate greater net operating interest income and non-interest income, providing a superior return on invested capital.

Provision for loan losses increased approximately \$2.3 million sequentially on continued loan portfolio growth. Net charge-offs increased slightly to 17 basis points on seasoning of loans, up from 15 basis points in the prior quarter and down 3 basis points from the comparable period last year. This low charge-off number continues to reflect the high credit quality and conservative mix of our portfolio.

Commission revenue decreased 34 million dollars sequentially but grew \$19 million year over year. Retail commissions represented a little over 17% of total net revenue this quarter, down sequentially from 21% in the second quarter. Gains on sales of loans and securities increased 4.9 million quarter over quarter and decreased 5.8 million versus a year ago.

On the expense side, our commitment to disciplined expense management and operational efficiency continued. Total operating expenses excluding corporate interest increased 2.3% sequentially to \$359 million. This includes, however, the unusual items of \$18 million in increased fraud and \$17 million of restructuring which I will discuss in a minute.

Operating margin excluding these items was a solid 44%. Compensation and benefits decreased \$15 million sequentially to 19% of revenues as a result of three factors: one, a decrease in variable compensation in our business given the lower sequential volumes; two, a decrease in performance based compensation based on business unit performance; and three, head count synergies resulting from integration and restructuring. We expect compensation and benefits to run at an annualized rate of approximately 19 to 20% of revenues on a going forward basis.

As Mitch noted, included within our EPS numbers, we had five unusual items this quarter that deserve some discussion. First, we exited some of our California offices as a part of facilities consolidation. This resulted in restructuring charges of approximately \$17 million for the quarter. We expect to take an additional restructuring charge of about \$10 million in the fourth quarter as we complete our facility consolidation.

Second, as Jarrett discussed earlier, the increase in fraud represented \$18 million of the increase in the Other Expenses line item. Third, the market resurgence in September provided an opportunity for us to realize gains on certain of our corporate equity holdings. During the quarter, ISC's stock price had an intraperiod high and we opportunistically took approximately \$14 million in gains this quarter above what we had planned.

Fourth, as we closed the sale of E*TRADE Professional, we had a \$5 million pre-tax equivalent gain in discontinued operations. And fifth, largely as a result of the favorable resolution of a tax issue related to pre-2002 earnings of a foreign subsidiary, we saw a \$9.7 million discrete tax benefit. Taken in the aggregate, these five unusual items net to approximately zero within our GAAP EPS.

Market seasonality once again provided a good opportunity for us to create value under our share repurchase program. During the quarter, we purchased in the open market approximately \$35 million of stock or roughly 1.5 million shares at an average price of 22.79 per share. After this purchase, we have approximately \$97 million still available under our Board approved share repurchase program. Including the effect of our share repurchases this quarter, our overall debt to

equity continues to decline as modeled. Our leverage ending Q3 was 31%, down from 33% last quarter and 41% from the fourth quarter of 2005.

We continue to look to deploy our capital against the projects with the best return. This past quarter we continued to invest in the growth of the company, reduced our overall leverage, and enhanced shareholder value through share repurchases.

Earlier this afternoon, we announced a narrowing of our 2006 guidance range. Our previous guidance of \$1.42 to \$1.52 excluding acquisition related integration expenses has been narrowed to \$1.45 to \$1.50. Our previous GAAP guidance of \$1.37 to \$1.47 has been narrowed to \$1.40 to \$1.45.

In summary, we are pleased with the company's core performance during the third quarter and the market resurgence we have seen in the past weeks. Our focus continues to be on building an integrated global franchise to deliver superior long term shareholder value.

With that operator, I would like to open the call for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question is coming from Rich Repetto of Sandler O'Neill. Please go ahead.

<Q – Richard Repetto>: Yes, hi guys, how are you doing?

<A – Mitchell Caplan>: Hi, Rich.

<Q – Richard Repetto>: The first question on the one-time items because there are several, so I'm just trying to see the acquisition related charges. That's nowhere – that's still above and beyond the five items you talked about.

<A – Mitchell Caplan>: Yes. So in other words what we did, Rich, is – I think we tried to separate out what we thought the marketplace knew versus what they didn't know. So if you start, we assumed and we had always said that this year we have about \$0.05 of integration related expenses in connection with Harris and Brown: 3 in Q1, 1 in Q2, and 1 in Q3. So I think the consensus that's out there really reflects \$0.36 before that \$0.01 of deal related expenses or \$0.35 GAAP and so that's why we reported our numbers that way.

Separate and apart from that, there were these five pieces of information which I think the marketplace didn't know and we wanted to clearly delineate, one of them obviously being the restructuring charge. I guess to be clear, the purpose of the restructuring charge is we made up our minds even a number of years ago to begin to move more of our operations from the West Coast to the East Coast, and in the process of doing that and moving different parts of the business from an operational perspective over to the East Coast, we ended up with a significant amount of excess space in certain of our California facilities. And so this was the quarter that we made the decision to exit those facilities entirely and that's when you see the restructuring charge associated with that.

Similarly, we had this experience of the additional fraud that was unexpected. And again, I think we were pretty clear that we believe that we've made a significant number of operational changes and technology changes. We've seen that level of fraud in the last three weeks or so reduced to almost zero as a result of the changes we're making. But yet we are continuing to work with others in the industry who are experiencing some of the same problems as well as the regulators and the SEC and the FBI and everybody else because it appears to be concerted rings, at this point Eastern Europe and Thailand. But we wanted to make it clear that that was an unusual item.

And then offsetting those items were the one-time benefit we got from the tax as a result of the foreign benefit from I guess 2002 or 2003 as well as the ISC shares that we sold for an additional gain over and above the 50 million or the 12.5 million a quarter that we had originally guided back in last December. We have left, I guess as contemplated, about \$12.5 million which we would anticipate exiting in Q4 of this year. And then finally, the disc ops benefit associated with the final sale of E*TRADE Pro; and I think as Rob walked you through, all five of those end up netting to about a zero impact.

<Q – Richard Repetto>: Okay. I mean we can certainly go through more detail after the call, but that helps, Mitch. I guess second question is what was on people's minds I guess last week, but the B of A zero commission offering, what have you seen, what have you learned, and what do you think, I guess, since that occurred?

<A – Mitchell Caplan>: A couple quick thoughts, the first is that I think the market missed it. I'm pretty convinced that the B of A offering wasn't really an offering against our business model or the business model of many of our direct competitors. I think the B of A offering was based entirely on their desire to try to grow deposits. I think many people recognized that growing deposits has been

very difficult in these last couple of years and that doing it cost effectively has been extremely difficult.

When you have a traditional brick and mortar franchise, you really only have a couple avenues in terms of growing deposits. One obviously is to change your whole pricing strategy, impossible to do for their business model. Another one is to create a subsidiary very much like Citi or HSBC Directed (sic) [Direct], and I guess they chose not to play in that game. They continue to build out branches and the cost infrastructure. But ultimately I think they made the decision that in exchange for \$25,000 at a very low interest rate, they would offer trading with no charge. This is not free trading. All day long, I would take \$25,000 from our customers at 40 or 50 basis points of cost. I would clearly not characterize that as free. In fact, I would characterize that as extremely profitable.

So when you look at the marketplace in which they're playing, I'm pretty convinced that they were really competing against their fellow brick and mortar brethren in the deposit gathering arena. It's wise from our business model and I guess our perspective, we've always been of the belief that the customer you want is not a banking customer. It's why we sold Telebank E*TRADE. If you want to go after an investing based customer and you want the customer whose demographics and whose behavior based segmentation is about value, somebody who says I understand that in exchange for traditional brick and mortar distribution, I go with non-traditional distribution and I get better value and I get better value through pricing. I get better value through technological integration and innovation of products and I get good value in service. That's always been the customer that we're going after and that we've been able to penetrate and grow. It's not the customer who B of A is trying to attract.

So when I look at it, my view is that they're neither going after the core customer that we're interested in nor can they afford to from their deposit pricing strategy, and that with respect to our customers who want to trade actively, not even remotely of interest. I'll tell you, we get about 25,000 calls a day into our system. So in the last, I guess since Wednesday on that announcement, we've had about 150,000 calls come through our system. Of those 150,000, we've had about 160 that called about the B of A offer. Since then, we've been tracking and we have seen virtually no TOAs [Transfer of Assets], no ACATs [Automated Customer Account Transfer], no movement as a result of that offer. Clearly we'll continue to monitor it but my view is it really isn't playing in our space and we have therefore no interest, no desire, and have no intention of trying to competitively respond because we think it's unnecessary.

<Q – Richard Repetto>: Understood. Someone was going to ask that question, so I might as well have asked it. Very last quick question, I just want to show Rob we're paying attention out here. It looks like on the second quarter, the retail client assets were restated downward and specifically in the cash and money markets by about 600 million, if I got my numbers correct. Can you give me some color?

<A – Robert Simmons>: Absolutely. This quarter, we had for the first time the technology through ADP to be able to monitor our activity on a settlement day basis as opposed to a trade day basis. Looking at things on a settlement day basis is much more conservative and accurate, we have felt. And it's actually, for everyone that's on the call, it's actually footnoted actually in the press release what we did.

Through the end of September, the end of the third quarter, there was about a cumulative \$600 million difference between the trade date numbers that was our previous methodology and settlement day, which is our new methodology. That's \$600 million of cash that really we were not earning any economics on. It was just there as a reporting type anomaly as a difference between trade date and settlement date. So we – as we looked at it, we just felt like moving to a more conservative methodology that better reflects the underlying economics made a lot of sense. Again, this quarter was the first quarter that we had the technology to begin doing that. So there's no meaningful impact to quarterly cash flows for this. It's just a one-time catch up and there's no

economics to that. We took the opportunity with this technology to make this change this quarter. And going forward we'll be consistent with that.

<Q – Richard Repetto>: Well, on an apples to apples basis, I guess would customer cash still have grown by one point? I guess it is an apples to apples basis.

<A – Robert Simmons>: Yes, absolutely.

<Q – Richard Repetto>: Okay, thanks guys.

<A – Mitchell Caplan>: What this was, Rich, as Rob ultimately explained it to me was a one-time catch up, historical catch up for all the years we were reporting settlement – trade date as opposed to settlement date.

<Q – Richard Repetto>: Yes, I just wanted to let him make sure that he knows we're looking at the old numbers as well as the new numbers.

<A – Mitchell Caplan>: You got it.

<A – Robert Simmons>: I'm impressed Rich.

<Q – Richard Repetto>: Thanks guys.

Operator: Thank you. Our next question is coming from Matt Snowling of Friedman Billings Ramsey. Please go ahead.

<Q – Matt Snowling>: Hi, guys.

<A – Mitchell Caplan>: Hi, Matt.

<Q – Matt Snowling>: Hi, my question is about moving the clearing over to the bank. I was just wondering if you could quantify how much capital you expect to free up and maybe how long it takes to deploy that capital.

<A – Mitchell Caplan>: Again, Matt, what I prefer to do is address it entirely in the call in December when we'll give earnings guidance. I think we were pretty clear in the script that we expect to receive approval literally at this point in a matter of a few weeks or under a few weeks. And my guess is that we will be able to – we've been preparing for it long enough that we'll be able to structurally make it happen in reasonably short order.

There are economic benefits associated with it as we said in connection with capital, in connection with hedging, and in connection with lower cost of funds. But again, the guidance for the rest of the year contemplates exactly what we know currently about the rest of the year. And we will be much more specific in the call in December on guidance as to the economic benefits for 2007 and beyond.

<Q – Matt Snowling>: I thought I'd try, Mitch.

<A – Mitchell Caplan>: I got you Matt, but sorry.

<Q – Matt Snowling>: Another quick question then. On the balance sheet, you obviously grew that pretty strongly during the quarter, about 2 billion or over 2 billion, I guess.

<A – Mitchell Caplan>: Yes.

<Q – Matt Snowling>: It looks like it's primarily funded with wholesale sources. I'm just wondering, is the thought or the hope to replace that wholesale funding over time with more deposits or is it just taking an opportunity to put the assets on the books even though it may have some impact on the spread but it's just accretive, unless...

<A – Mitchell Caplan>: I don't know what you're saying but we fund it almost entirely with retail. So we fund it on the liability side with about 1.5 billion of cash and on the asset side, we had virtually 100% growth in mortgage whole loans.

<Q – Matt Snowling>: I was just looking at your average balance sheet and the repos were up 1 billion.

<A – Mitchell Caplan>: Yes, so that's on the liability side. It grew 2.4 billion. That's right. We funded about 1.5 billion of the 2.4 billion in growth with customer cash, which was the strongest growth we had, the second strongest growth ever we've had in customer cash. The difference, we funded with wholesale borrowings and we will in fact replace them in reasonably short order with customer cash that's coming in.

But on top of that, one of the things we experienced, good question because it's a good point to make. I think in the comments that Jarrett was going through, for the first time we are beginning to be as focused on the earnings power and ultimately where we go with spread and the contribution from both sides of the balance sheet. Traditionally, it has been the liability side or cash that has really driven the value, meaning that we brought in 5 billion I guess in these last five quarters or so of customer cash. It's been very cost effective from a cost of funds perspective, from a duration perspective, and it's widened our spread.

We have not really relied very much on the credit side of the balance sheet. In the last probably six to nine months, we've made some significant changes from an operational perspective around the origination again of credit products, so margin, mortgage, key lock, things like that. And one of the thing that's pretty – I was pleased with in the quarter is that we were able to grow our mortgage originations quarter over quarter by 5%, obviously in a market where mortgage originations are declining elsewhere generally speaking in the environment. And rather than originate mortgages which we have typically sold into the secondary market of our customers, we're now keeping the vast majority of them on balance sheet. So you saw a significant increase on a percentage basis of the numbers.

So I was really quite pleased that what we actually did is we got out of mortgage backed securities and replaced those mortgage backed securities in this past quarter with mortgage whole loans and home equity lines of credit. Again, credit characteristics on average are a 740 FICO score. LPVs on the first are at about 70%; LPVs on the key locks and seconds are at about 77 – 78%. I feel really good about the credit characteristics and frankly the ability to finally be in a place where we're starting to really originate again.

<A – Robert Simmons>: Let me just give you one other data point on that. If you look at the year over year numbers, a year ago the positive percentage of our interest paying liabilities were about 53%. Today they're over 61%. So we've made some very nice progress toward improving that mix.

<A – Mitchell Caplan>: The same is true with the loans as a percentage of assets.

<A – Robert Simmons>: Absolutely.

<A – Mitchell Caplan>: Yes.

<Q – Matt Snowling>: I guess one quick question then. In terms of the spread, how did it end the quarter?

<A – Mitchell Caplan>: How did it end the quarter? Rob's shaking his head. I was going to say favorably.

<Q – Matt Snowling>: I don't think that helps.

<A – Robert Simmons>: We only have one spread metric.

<A – Mitchell Caplan>: Exactly. The spread metric, the one Rob gave me, the one we released in the quarter was 286.

<Q – Matt Snowling>: Alright guys.

<A – Mitchell Caplan>: But again I think it's fair to say that we guided for the second half of the year between 285 and 300. We're cognizant of that and we also recognize that what we're really trying to do is take a look at a rate/volume analysis.

Listen, Matt, one of the things that's pretty interesting, our thesis a long time ago and what we've been trying to determine is when you look at spread, spread is nothing more than a proxy for earnings growth and revenue growth, right? It's just a metric when you multiply it times the balance sheet. What you really should be thinking about is what actions can you take to generate significant expansion of earnings and when you do that, can you do it at an acceptable return on invested capital. And so our theory for a while has been, even if we see some spread compression which is why we guided from last year – I mean last quarter when we were at 289 to 285 to 300 because we knew that if we didn't grow the balance sheet as much because we weren't engaging with customers as much, we'd have a higher spread.

On the other hand, if we engaged with customers, there was a chance that you would have a bigger balance sheet and see some spread compression. So the question was if you were willing to offer a bigger variety at appropriately priced products on the deposit side or the liability side of the balance sheet, what else were you getting for those – from those customers. Where else was it helping you within the overall income statement? Where were you seeing the economic benefit?

One of the things that we've tracked is some of the metrics that Jarrett gave you which were things like as we looked at this growth in 1.5 billion in customer cash, we saw 80% of it in balances come from existing customers, from the investing base customers. We saw all of them actually increase their balances, so it wasn't a question of moving within the system. There actually were net increases to their overall balances in the system. 50% of them increased their balances by more than 20%.

Then we went back and tracked it and said okay, what else happened with those customers? When you look at that sample of customers, how did they perform on a DART basis? How did they perform with respect to options volume? How did they perform with respect to margin balances and commission revenue? I can tell you that when you look at them, if you recognize that the broader customer base was down 18%, we meaningfully outperformed with respect to DART in that it was a positive number. The same trend lines occurred across options, across commission revenue, and across margin. So we recognized that these customers are in fact not only deepening their engagement as it relates to the balance sheet, they're also outperforming with respect to the broader base of customers and a lot of the other drivers. And so this was always our thesis and it's why we intend to continue to be very focused on driving the relationship around these investing customers.

<Q – Matt Snowling>: Great. Understood, thanks.

Operator: Thank you. Our next question is coming from Richard Herr of KBW. Please go ahead.

<Q – Richard Herr>: Hi, good afternoon.

<A – Mitchell Caplan>: Hi, Richard.

<Q – Richard Herr>: Just quickly, maybe spend a little time on the fraud here. I was just curious, do you have any insurance against this type of fraud or is this something you can't insure against?

<A – Mitchell Caplan>: We have insurance. There is insurance out there which may or may not cover it.

<Q – Richard Herr>: Okay, so potentially you could have some degree of recovery in coming quarters.

<A – Mitchell Caplan>: Potentially. I'm looking at Rob.

<A – Robert Simmons>: We'll keep you posted.

<Q – Richard Herr>: Okay. And did the –

<A – Mitchell Caplan>: I mean it's a great question, Richard, but I think the more important...

<Q – Richard Herr>: Did the [inaudible] RSA password devices to your customers, I mean does that aid at all in preventing this type of behavior?

<A – Mitchell Caplan>: Absolutely.

<Q – Richard Herr>: It's just a matter of not everybody has those yet? Or...

<A – Mitchell Caplan>: That's absolutely right, it's not everybody has them and then when they have them, not everybody chooses to use them or use them consistently.

<Q – Richard Herr>: Understood.

<A – Mitchell Caplan>: I suspect you're going to see – I think that this thing is so widespread and it's such a significant impact on the industry at large and you have so many players involved in this, not only from the Street, from Wall Street, but also as I said with respect to the SEC and Secret Service and the FBI and everybody else that I think you're going to end up seeing structural changes in the industry as well.

<Q – Richard Herr>: That's helpful. And on your spread, again within your guidance range of 285 to 300, is that still a good range for Q4 or was that some of the thinking that brought down the top end of the guidance?

<A – Mitchell Caplan>: Rob's looking at me because he's not going to let me – as you know, I think as a policy we don't give quarterly guidance. We only give annual guidance. So I think that when we thought about the second half of the year, both Q3 and Q4, we did think about where we thought each of those metrics would be. So again at that point, we were comfortable with the range for the second half of the year of 285 to 300 and we would continue to engage in rate volume.

I think as you look at the top end, mostly what's driving the decision around the top end was the decline in DARTs this quarter. So if you look at what does the new range imply, I think it implies anything from \$0.37 to \$0.42 in Q4, up from \$0.36 in Q3.

<Q – Richard Herr>: That's helpful. And on the rates, I was looking at here the retail deposits was 2.67%, up from 2.33. Is that just a matter of customers moving from money markets to more of a fixed rate product like a CD, or is it just a matter of rates going up overall?

<A – Mitchell Caplan>: Yes. Hedge funds during that same period were up 35 basis points as a point of reference.

<Q – Richard Herr>: Okay, so that's your...

<A – Mitchell Caplan>: So, actually I think we did quite good.

<Q – Richard Herr>: Sure. And lastly on the gains, can you give us an update on how much you have left of the Softbank gains and did you take any this quarter?

<A – Mitchell Caplan>: We didn't take any Softbank gains. What we have left is really no longer Softbank but is E*TRADE Japan. And Rob's looking at me and saying that right now I think the only thing that we have said from a disclosure perspective is that we would anticipate exiting. I think as we said last December, we believed that we would sell virtually our entire stake in ISC during the course of this year of 2006. Again as I said earlier we have every belief that we will continue to execute on that strategy. And we had originally guided to 50 million because that's what the gain number was as of last December. Fortunately I guess for us, the market moved up. ISC stock moved up so we've been able to extract actually more value out of the ISC shares than we thought. We have about \$12.5 million in gains that would be available to us in Q4. And I think that's pretty much what we had modeled again originally at the first of the year which was based on 50 million throughout all four quarters.

<Q – Richard Herr>: Alright, that's helpful, just one last quick question, how does October look with all this press about Dow 12,000?

<A – Mitchell Caplan>: You know, we never give specifics. September was up I guess 10%, in December, we seem to be pleased with those numbers. I guess some of our competitors have reported and haven't been quite as strong, so that's a good sign for us. And I guess directionally it would be fair to say as we always do that if the market's up, usually volumes are up and everybody's benefiting from it. So we're going to move in the same direction as the rest of the market. I also think in Rob's prepared comments, he did say that he was pleased with the reengagement in the market. So you take it for what it's worth.

<Q – Richard Herr>: Thanks. Thank you very much.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you. Our next question is coming from Mike Vinciguerra of Raymond James & Associates. Please go ahead.

<Q – Michael Vinciguerra>: Thanks, good afternoon guys.

<A – Mitchell Caplan>: Hey, Mike.

<Q – Michael Vinciguerra>: Specifically on the income statement, one minor item kind of caught my eye on the expense side, the clearing of full brokerage costs down about 2.5% for the quarter. Yet your retail trading and principal transaction revenue both down in the low to mid – well, I guess 20% for retail, 28 for principal. What kept that particular line elevated on the expense side?

<A – Mitchell Caplan>: If you remember now that we've consolidated the business from a retail perspective between what you would think of as bank and brokerage, you do have an offset in clearing being down because of volumes, but it also includes servicing which means servicing of the whole loans, which as you grow your whole loan balance sheet is going to go up. So while you saw an 18% decline in DARTs, you also saw a \$2.4 billion average increase in whole loan.

<A – Robert Simmons>: This line item is not just correlated with trading volumes anymore.

<Q – Michael Vinciguerra>: Okay, that makes sense. I had a question on how you guys process you customers' trades because historically you've done probably two-thirds of your trade processing internally or I guess executions internally. And it looks like on the NASDAQ side the last few quarters, that has been dropping pretty precipitously with you sending more trading volume out to Knight and Citadel in particular. I don't know what the numbers are going to look like for Q3, but can you just talk about what your strategy has been there, what's been going on, why we've seen the shift?

<A – Mitchell Caplan>: Yes, I think it's fair to say that it really is stock specific. So if you look at our rate of internalization, it really has been between 50 and 60, 50 and 55% for as long as I can remember and there's nothing that I'm seeing this quarter that's materially different. I think what is happening is that one of the things that we've done is we've actually been more disciplined about the stocks in which we are making a market with the idea that we will get reciprocal flow because if we have less stocks in deeper pools of liquidity, it's even better execution which is really what it's all about for us. And we would get reciprocal flow in those stocks and then in others where we feel we can't get the same level of depth, then we move those out to other market makers, Knight and otherwise. So I don't think there's anything that's happened. Dennis?

<A – Dennis Webb>: The only thing I'll add there is just there was a recently a publication that showed of the stocks that we do make a market in, we were actually ranked number one based on overall speed and quality of execution. So I think again as we finetune our market making model and continue to specialize, it's benefiting both our retail customers, E*TRADE retail customers, and others.

<Q – Michael Vinciguerra>: It makes sense, thank you. Just the last thing is on the overseas operation, you guys are very excited it seems about the opportunity there. Your European business or at least your International business was up stronger than the US, or stronger in the quarter, I guess. I'm just curious what you see as the growth drivers there in your UK business and I guess in Germany now with this new value proposition. And also you talked I think in the past about a complementary banking franchise potentially in some of these markets overseas to do what you're doing here in the US. Can you talk about that a little?

<A – Mitchell Caplan>: I'm happy to do it. So we really are incredibly excited about International and the reason why that's the case and the reason why I think we didn't talk about it for so many years is because I guess as you know, historically we came from a place of loss-making to now a place where we're actually driving a significant amount of revenue and profits from our International operations. But we truly did not want to get to a place where we began to focus on International until we knew that the investment was not significant. And so what I mean by that is that we could look at a retail customer and deal with them across all of our products. So whether it was trading which we were traditionally and have been traditionally doing for them in both the traditional locations of Europe and Asia, or whether it was moving into other asset related products, mutual funds, banking, or lending, until we knew that our core platform effectively was transportable and transferable across the globe. So your incremental costs would be really de minimis and you could drop a significant amount to the bottom line.

So we feel as we're getting ready to enter into 2007 that we really are basically at that place. And so as a result, you're right, we've gotten very focused on these other products, first in Europe and

then secondly in Asia. In order to do that, we need to have a banking license. We will talk more about that as we give guidance for 2007 in December. But I think it's fair to say that we're well on our way with respect to a charter to deal with it in both our European operations and passporting throughout all of the EU countries as well as in Asia. At the same time, we have come to the understanding, the realization, the recognition that when you look at some of the emerging markets, I guess I'd define those as India, China, and the Middle East, that we are far better served participating in a partnership. So India, as I described on the call, is the perfect prototype. And as I look at India, I'm really pleased with it because we're looking at so far, we've invested about 60 million or \$65 million to date for our equity ownership. We have tendered for another 20% of the company, which would basically put us in a control position. If you look at the economics though, our distribution back from the profits out of India, we're generating somewhere around a 14 or a 15% return and we also have all the upside associated with the future growth.

So that model is one that we think is interesting. I just came back from a three week trip. I spent about a week in China and a week in India and then a number of days in Europe. I suspect that we will obviously continue to deepen our strategy and our relationship in India as evidenced by the tender. Ultimately I think over the long term, we have a real interest in Mainland China in structuring a similar kind of relationship. I mean part of that, Mike, is just – I mean last week I happened to be driving into the office and there was all this hoopla, as Jarrett says, around crossing the 300 million mark in terms of the population in the US. You go to China, it's 1.3 billion. You go to India, it's somewhere between 1.1 billion and 1.2 billion. And when you look at the power of the numbers, I mean we've had a website up for 5.5 months in China that's entirely educational only, with a small representative office in Shanghai and we've had significantly over 1 million registered customers come up and sign on and register to the site in order to start getting informed and educated about investing in China.

So we see over the long term that both of those countries have enormous power in the numbers. The goal for us was to make sure that we could enter in a way in which we would generate both a current return that was satisfactory to us as well as have all of the option for future growth around them. So I guess we will clearly spend more time in December talking about the strategy from an international perspective and answering more of your questions about the banking charters in Europe and in Asia and what it means for the growth of a global balance sheet.

<Q – Michael Vinciguerra>: Fantastic, thanks guys.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you, our next question is coming from William Tanona of Goldman Sachs. Please go ahead.

<Q – William Tanona>: Good evening, guys.

<A – Mitchell Caplan>: Hey, Bill.

<Q – William Tanona>: Just a question in terms of new accounts, obviously you guys did pretty good on the lending accounts this time in terms of net new accounts, but you still seem to struggle on the investing accounts. I know you also talked about the fact that you guys had some success in terms of bringing in assets from existing customers but I just want to get your thoughts in terms of how you might be able to get things going again on the net new investing account side as you think about the fact that you've already gotten through these acquisitions and now you've got to focus on growing that business from an organic standpoint.

<A – R. Jarrett Lilien>: Actually I was really, really pleased with the account growth across the board this quarter. If you look at the investing accounts, we talked about it in the script a little bit, the success that you're seeing in those bank accounts, up 50% year over year, over 70% of those

account openings were from existing investing customers. So what you're seeing is a great new account dynamic where the new accounts are representing a broadening and a deepening of current relationships, growing the revenue per account, the assets per account. All the quality metrics are being driven by fantastic new account generation that's really starting with the investing customer.

Also, as we've talked about, we're seeing in our targeted segment, the high value segment, a 30% annualized growth rate and that really starts again with the investing customer. So you dig into the numbers and it's a fantastic story all the way around.

<Q – William Tanona>: Well, I guess -- I'll repeat the question then because both you and Mitch have mentioned that it starts with the investing accounts. Obviously I see the success that you have with generating the bank accounts and we saw that this quarter. But what are we going to do to jump start the investing accounts so we see some net new account growth on that front?

<A – R. Jarrett Lilien>: Again, I think what Mitch and I talked about, it starts with the investing customer, and then you've got to look at what's going on in different parts – in times of the market. I mean the summer quarter is usually a pretty slow one and you look at that growth and still pretty good for a summer quarter but really the story of the summer quarter were interest rates going up and investing customers, especially we know for a fact that our investing customers tended to be selling into market strength and basically diversifying their portfolios and going to a more defensive posture and more into cash product. So it really shows how the market or the model is working, in a market where customers are being defensive, delevering, taking a little margin debt off the table. They want to go into a more defensive posture, getting into cash product. It's exactly what they did and our model benefits from it.

What I would expect is you'll continue as we go forward, we continue to take share from the traditional players on the investing side. Expect that to continue; and in a different environment, I think you'll see it differently. You could see less growth in banking related accounts and more growth in the investing accounts. But I think the model again is working precisely the way it's supposed to given the environment that it's been faced with.

<A – Mitchell Caplan>: The one thing I would add, Bill, is I sort of understand your point, meaning that one of the challenges – so when I look at it, top line growth in accounts broadly defined based off of 4.4 million is 5 – 6% a year. It's just too slow. And that said, we are growing our core segment. So the ones that really matter most to us and we define those based on revenue generation and that revenue generation comes from either transactional capacity, i.e., people who trade actively, are in the transacting space, or assets. So they come to us and they engage with us either in mutual funds or cash or borrowing on credit. And as Jarrett said, we're growing all of those segments in combination at about 30% a year. That was the first proof point that we wanted.

As we went through this model and began to segment, did we believe as we spent more marketing dollars actively going after them that we could see a significant growth in those accounts. And we can see it A) from new customers; B) from current customers, meaning migration up from your Main Street, and you're not actually seeing that part of it in the numbers because the numbers there you're seeing are just the absolute new accounts as opposed to what we've been able to do with the core customer by getting them to be able to migrate up as well as lowering both attrition and inactivity. So this quarter, one of the other things that pleased me is for the first time in a long time, you saw the inactivity level down pretty significantly in a quarter where you otherwise might see inactivity go up. If one of the definitions around inactivity is trading and you know it's seasonally slow in the summer and DARTs are down, you might actually – and traditionally might very well expect to see inactivity go up and we actually saw it decline.

So a lot of this for us has been a proof point about the investment that we've made in marketing. I think you know our marketing dollars are up significantly in '06 over '05. They were up significantly

in '05 over '04. Long before – we're going to test and learn. So before we just go out and spend, in our minds some of our competitors have spent significantly more in marketing and not generated anything for it. So we're seeing pretty decent returns across the board for our marketing investment and I think we will clearly take that into consideration as we look at '07 and beyond and try to build out the franchise.

<Q – William Tanona>: That's helpful, thank you. I guess as you think about the marketing spend and you think about the Bank of America's coming out with that offering, clearly you guys are unique in some of the online brokerage space by offering both the lending, banking, and investment side of it. What about your thoughts in terms of turning the tides and going after the traditional banking model considering that your rates are significantly better than the rates that those banks are offering?

<A – Mitchell Caplan>: I think that's exactly what we've always intended to do. The difference is we have zero interest in the traditional banking customer that has 800 or \$900 in an account. You make all of the money off of that customer by literally paying them 20, 30, or 40 basis points and you charge them fees for everything that they do. That's the traditional banking model. That's why I sold Telebank. I think it's much more interesting to recognize that embedded in some of these banking structures, brick and mortar, there are some investing base customers. To the extent that we have been able to gain share from any of these banks, it has only been really with the traditional investing based customer and your point is right. We have a competitive differentiator that is virtually impossible to match given their cost infrastructure.

<A – R. Jarrett Lilien>: And that's backed up too by some of the stats we see in the business. When you look at Quick Transfer, which is that functionality where you can push a button and either move money into E*TRADE or out of E*TRADE, we still see a positive inflow of transfers in versus transfers out of anywhere between 2 to 1 and 3 to 2. One of the biggest places that we net take cash is Bank of America and other traditional banks and other traditional players. That's what we expect to continue to be the case with our value proposition.

<Q – William Tanona>: Great. Thanks for the color, guys.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you, our next question is coming from Patrick Pinschmidt of Merrill Lynch. Please go ahead.

<Q – Patrick Pinschmidt>: Thanks, guys, good evening.

<A – Mitchell Caplan>: Hi, Patrick.

<Q – Patrick Pinschmidt>: A couple quick questions, I guess the first point on margin debt balances, they were down 10% in the period. Should we -- looking ahead to the fourth quarter here expect this to bounce seasonally and -- helped by the positive market backdrop?

<A – Mitchell Caplan>: Yes.

<Q – Patrick Pinschmidt>: Okay, great, and then second question on the restructuring charge for your West Coast operations, I think \$10 million you mentioned in the fourth quarter. Is that included in your guidance?

<A – Mitchell Caplan>: It is.

<Q – Patrick Pinschmidt>: It is; okay great. And then finally on International, you're running I guess about 14 – 15% of overall DARTs now given that you're heightening the focus on Europe.

What do you think is a fair share there? What would you like to see? I realize the denominator would grow but what do you think overall DARTs, coming from...

<A – Mitchell Caplan>: Let me answer it in a different way, if I may. We have challenged International that by 2010 they have to account for 30% of our overall revenue, whatever that revenue dollar amount is in 2010. That has to come not only from DARTs but also from cash and credit relationships, so the traditional model.

<Q – Patrick Pinschmidt>: And would you expect the overseas customer relationship would have more of a transaction revenue bias versus the US one?

<A – Mitchell Caplan>: No.

<Q – Patrick Pinschmidt>: Okay, great.

<A – Mitchell Caplan>: When you look at the customer, the behavior, certainly in what you would look at as the traditional EU countries and again some of the more traditional Asian countries that we have been looking at, what we have basically seen is the behavior from a demographic perspective with mass affluent looks the same.

<Q – Patrick Pinschmidt>: But currently though your revenue generated in Europe and overseas is more transactional.

<A – Mitchell Caplan>: It is almost entirely transactional because we're not offering anything yet.

<Q – Patrick Pinschmidt>: Okay, okay. Great, thank you.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you. Our next question is coming from Roger Freeman of Lehman Brothers. Please go ahead.

<Q – Roger Freeman>: Hey, good evening.

<A – Mitchell Caplan>: Hey, Roger.

<Q – Roger Freeman>: With respect to the growth in cash balances during the quarter, what do you attribute that number growing at the second highest level to? Is it any particular marketing effort or increased rates? Obviously rates did go up because of Fed hikes. What do you specifically point to?

<A – Mitchell Caplan>: I think it's a great question. One of the things I guess that makes us feel great is that again, even though it is the second highest quarter, the highest quarter was 1.6 billion. We've had a couple of other quarters right at 1 billion. So you're beginning to see a trend line evolve.

What I believe is happening is twofold. One is as we're able to deepen the engagement with that investing customer and we're making them better aware through marketing that we offer a whole suite of products, all of which have value, so we're so much more than what used to be an online trading business. They are recognizing that it's an interesting place to aggregate their cash and get real value for it. And that cash is not only their to be invested cash, but it's also their fully invested cash, meaning when they keep X% of their liquid net worth, we're finding somewhere between 15 and 18%, in cash at all times and clearly in situations like that functionality matters, service matters, but rate matters. And because of our lower cost infrastructure, we have a competitive differentiator. So I think as we have begun and Nick [Nicholas A. Utton, Chief Marketing Officer] has done an

excellent job from a marketing perspective to make our current customers and prospective customers much more aware, it's made a big difference.

We also happen to be playing to an audience at a time when it's interesting. This idea – you actually have seen an increase, meaning that traditionally you may only see 13 or 14% of liquid net worth in cash. It may have moved to 15, 16, 17, 18 percent in times like that. And also, you're doing it in a place where there is to your point a little higher interest rate environment and Fed funds have been moving up, and so you play into the right audience at the right time with the right product.

<Q – Roger Freeman>: Okay, and just as a corollary, you mentioned that you look at these customers and found that they were more active on a number of fronts: trading, higher credit balances, et cetera. Are these – was their activity heightened during this quarter as the cash balances increased or do you just identify those customers who have already been pretty active?

<A – Mitchell Caplan>: Yes and yes. So we did a bit of an aging and we also looked at the behavior specifically in quarter and both of those statements are true.

<Q – Roger Freeman>: Okay, and then lastly, I guess on the lending side, can you talk about the impact the Loan Optimizer has had? Obviously, your mortgage balances were up. I know there's a component in there that ultimately you want to grow margin lending. Now that was down partly seasonally. When do you think that might kick in, getting people to use margin lending for things other than buying stock?

<A – Mitchell Caplan>: Yes, I think we're just starting to get there. Part of it was we had to get the operations into place where it could work and it could scale the way we needed to and again generate the out margins we wanted to in that business. We feel pretty good about it from an operational perspective now. And I think you're beginning to see a lot of this growth as a result of the functionality around things like the Optimizer. You're seeing more and more of our customers begin to engage with it. I think that the Cash Optimizer clearly was one of the key drivers in the \$5 billion deposit growth you've seen in these last five quarters that have all come organically. Our hope certainly and our expectation is that you'll begin to see credit be the next playground for us as we go into 2007.

<Q – Roger Freeman>: Okay, thanks a lot.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you. Our next question is coming from David Trone of Fox-Pitt Kelton. Please go ahead.

<Q – David Trone>: Yes, good evening.

<A – Mitchell Caplan>: Good evening.

<Q – David Trone>: I just thought it wouldn't be a fun call if we didn't bring up this B of A thing again. So let me just play the devil's advocate in one little context.

<A – Mitchell Caplan>: Sure.

<Q – David Trone>: If I'm an E*TRADE customer that trades a lot, why wouldn't I want to use E*TRADE for your great analytical tools which I could free ride by keeping my account open, maybe even at worst case some modest funding in there. I then use B of A for free execution up to 30 times a month. The only thing I have to really do on the interest rate side is open up a CD account and they pay 5%, which is the same as pretty much everybody else, ING Direct et al. I

could avoid the transactional account issue. I know that's not going to apply to a lot of accounts but they are pretty profitable types of people. Why wouldn't I want to do that? What would stop me from doing that?

<A – Mitchell Caplan>: How long have you got, Jarrett? Go ahead.

<A – R. Jarrett Lilien>: You've got to go back to – one of the key parts in there is what Dennis talked about earlier. A third party analysis shows that we're number one in execution in the stocks that we trade, and that's really the biggest part of it. I mean the example I've given a few times; if you're someone trading a thousand shares and you're buying a \$15 stock, you buy it with us at \$15. You buy it somewhere else at \$15.02; that just cost you 20 bucks.

So our sophisticated customers and that's what active traders are, they're smart enough to know that you get what you pay for. And free means you're going to be sacrificing on execution quality. You're going to be sacrificing on functionality. A lot more customers these days are using options in conjunction with their equity trades. You just don't get that at Bank of America, so especially active trader customers are not interested in this.

<A – Mitchell Caplan>: And I think frankly when B of A did their conference call and talked about it, they clearly stated that they had zero interest and zero belief that they were trying to go after the active traders. It just wasn't part of their market. I mean it's interesting. I'll give you some quotes. You'll find this anecdotally interesting.

We do a dinner once a month with Platinum customers and those customers are decent size. We do them in various cities across the country on the same night. And I asked for RMs to give me feedback when they discuss the B of A answer. Here it was, customers' sentiment at last week's Platinum dinner, "There is no free lunch, this is a gimmick." Second, "B of A is bottom feeding." Third, "B of A's brokerage and trading act is not their core competency." Next, "Why would I keep a portion of my money in a low yielding product?" Fourth, "Trade execution concerns." Next, "I trade multiple accounts and the B of A offer is by customer and not account."

So all I can tell you is we have to watch it. We would be foolish not to watch it but in my mind, I hear you. Customers don't want to have to be forced into a CD to get 5% at some term. They want flexibility. They want their cash. They want to be able to move it. They want a fair rate for the flexibility of the term that they're interested in, one that has significantly higher value than you're going to get at B of A. This is nonsense. There's no such thing as a free trade. No charge with 25,000 bucks and look at B of A's typical average cost of funds.

<Q – David Trone>: Yes. I guess you mentioned yourself that perhaps – you didn't use the word desperate, but to the extent that they are highly motivated to get deposit accounts and the cost of executing the trade isn't that much, you know that. So regardless of their motivations, I mean it as a negative – if it steals some customers, it steals some customers. I think it's a question of – I think the one thing that resonates with me is the cost of the execution, the extent to which the guy that trades 20 – 30 times a month recognizes that cost.

<A – Mitchell Caplan>: Yes, but he recognizes much more the execution quality. That matters – I don't know. Have you ever sat in focus groups with active traders?

<Q – David Trone>: Well yes, but you can cherry pick a lot of everything but the execution by just keeping your account open somewhere else.

<A – Mitchell Caplan>: Yes, but you're executing through them.

<Q – David Trone>: Right, right, yes. So that's the key. That's really the key issue.

<A – Mitchell Caplan>: You getting inferior execution quality.

<Q – David Trone>: And to my point, you think the type of person that trades 20 to 30 times a month, they are savvy enough to know that.

<A – Mitchell Caplan>: Are you kidding? Absolutely.

<Q – David Trone>: Okay.

<A – R. Jarrett Lilien>: No you should – one of the most common customer service calls in busy times are people who want to question – the people that trade 20 or 30 times a month, questioning every execution in a volatile market.

<Q – David Trone>: Got you.

<A – R. Jarrett Lilien>: So I guarantee you they watch every penny.

<Q – David Trone>: Okay, great. That's a good explanation. Thank you.

Operator: Thank you. Our next question is coming from Campbell Chaney of Sanders Morris. Please go ahead.

<Q – Campbell Chaney>: Hi, guys. I'll try to make this really quick. Can you give us an idea of the mix in your loan portfolio? You did mention about credit. Where are you going to be pushing products through the system going forward? What's going to be your let's say flagship lending product?

<A – Mitchell Caplan>: Do you know what? It's a great question and it's hard to answer because I don't know if this makes sense to you, Campbell, but my experience is you can't push the product. You have to sell the product that the customer wants. And so if we end up in an environment where for example the Fed actually starts to ease next year, I suspect you will see a significantly increased demand for first lien position mortgages. If the Fed doesn't and it stays flat, you may be in a place where a home equity line of credit is a product that's more interesting and more engaging.

And then margin under any circumstances, I think one of the things that we've been trying to get customers to understand is it's nothing more than a collateralized loan. And so if we can give them a fair value in terms of a cost and the underlying collateral as a security, why not let them borrow against that for lots of other things, particularly if it's a lower cost borrowing than they might otherwise get, credit card or something like that.

<Q – Campbell Chaney>: So primarily it's going to be those three products and it's going to be a mixture of those three.

<A – Mitchell Caplan>: Yes, very much so.

<Q – Campbell Chaney>: Then lastly, with the fall in the ten-year treasury during the quarter and your mortgage backed securities portfolio, were you seeing any accelerated amortization that you had to take?

<A – Mitchell Caplan>: Not meaningful, mostly as a result of where we are in terms of the origination and premiums or discounts on our books, so no.

<Q – Campbell Chaney>: Okay, so it really didn't have any impact on the margin.

<A – Mitchell Caplan>: It really didn't.

<Q – Campbell Chaney>: Okay, great. Thank you.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you. Our next question is coming from Prashant Bhatia of Citigroup. Please go ahead.

<Q – Prashant Bhatia>: Hi.

<A – Mitchell Caplan>: Hi, Prashant.

<Q – Prashant Bhatia>: Hi, Just real quick, \$43 million of gains this quarter is 16 million above the line, 27 below, and that's about \$0.06. So I guess one is how sustainable are these gains as we look 12 months out? And two, what's the gain/loss position in both of the portfolios, maybe including the hedges that you have in place?

<A – Mitchell Caplan>: So if I remember correctly, the above the line gains this quarter were, what were they?

<Q – Prashant Bhatia>: 16 Million?

<A – Mitchell Caplan>: 16 million. I think we had guided anywhere consistently from 10 to 15 million or something like that. That was – maybe 5 to 15? The 5 to 15 is what Dennis is shaking his head that we've guided pretty consistently would be the range in any given quarter. If you go back and you look historically, that's a pretty good number. In fact, if you look at – we're down dramatically over what those numbers were a year ago.

<Q – Prashant Bhatia>: Okay. What's the position in the portfolio where the gains are coming from including again the hedge gains and losses?

<A – Mitchell Caplan>: Mostly they come from mortgage – the sale of mortgage backed securities and related.

<Q – Prashant Bhatia>: What's the balance? What's the net unrealized loss in that portfolio or gain?

<A – Mitchell Caplan>: We have a net unrealized gain in that portfolio. And we don't – I don't know. I don't know.

<Q – Prashant Bhatia>: Okay.

<A – Mitchell Caplan>: Dennis is shaking his head. That's not really where it comes from. Where it really comes from is the origination of mortgages in our retail business, which we believe are not mortgages that we would want to hold on the balance sheet. And so we then sell them into the secondary market and generate a gain as a result of that.

<Q – Prashant Bhatia>: Okay. And below the line gain?

<A – Mitchell Caplan>: Yes, the below the line gain I think we guided to 50 million this year which was the sale of the ISC stock. And again the point is that ISC appreciated in value throughout the year. We took advantage of that in selling it and generated additional gains. Our goal and I think we've always said was that by the end of the year, we would be out of the ISC stock.

<Q – Prashant Bhatia>: What's the position in that portfolio right now, gain wise?

<A – Mitchell Caplan>: Again, I think I had said that we have a number of shares left in it. The gain in it is about \$12.5 million and we would expect to take it in Q4.

<Q – Prashant Bhatia>: Okay. And after that, that probably zeroes out then going forward?

<A – Mitchell Caplan>: Yes.

<Q – Prashant Bhatia>: Okay. And then when you look at the net new assets this quarter, do you exclude the market benefit? What was that?

<A – Mitchell Caplan>: About 1 billion dollars.

<Q – Prashant Bhatia>: 1 billion dollars. Okay. And then in terms of the loan growth, the \$2.5 billion, how much of that loan growth is purchased versus originated yourselves?

<A – Mitchell Caplan>: Do you know what? I have – let me go to the numbers. The percentage of origination versus purchase is up dramatically and so it's improved hugely. So let me wait and go – I don't want to misstate it. Let me go back to the numbers and I'll give it to you when we do a follow up call if you'd like.

<Q – Prashant Bhatia>: Okay great, thank you.

Operator: We have reached our allocated time. Our final question comes from Michael Hecht with Banc of America.

<Q – Michael Hecht>: Hi guys, how are you doing?

<A – Mitchell Caplan>: Hey, Michael.

<Q – Michael Hecht>: I want to come back to the enterprise spread compression this quarter and how mix shift played a role there because I know you guys have already highlighted the mix of higher wholesale funding across repo and the FHLB advances but I wanted to focus a little bit on the free credits which are still about 20% of your cash balances and where you guys are still only paying about 1.25%. You know those continue to fall. They were down 10% in the quarter and presumably shifting to higher yielding areas for clients like CDs or money funds where they can earn 5% or more. With that differential in rates, won't that continue the mix shift, continue to challenge momentum in your spread?

<A – Mitchell Caplan>: Well, go ahead, Rob.

<A – Robert Simmons>: For the quarter, sweep went from 10.5 billion to 10.4, down 1%.

<Q – Michael Hecht>: I was actually talking about free credit balances on the balance sheet of the broker/dealer. In the average enterprise data it went from six-four to five-eight.

<A – Mitchell Caplan>: Yes, but free credits – what you also have to understand is free credits may have moved over into sweep and that sweep could be a net number and they could have moved into other transactional accounts, all of which have low balances. I guess more importantly in the aggregate, what you saw was Fed funds were up about 35 basis points. I think we were up about 35 basis points on the asset side and about 40 basis points on the liability side. Clearly we saw five basis points of compression as a result of the mix. But a part of it was also, if you look at the absolute numbers, part of it was that our wholesale funds went up in terms of cost pretty dramatically.

So we would expect to see some potential spread compression as a result of the shift mix. We would also expect to see an offset to that as we replace some of our wholesale borrowings with retail deposits and we would also, as we said, this quarter begin to see some benefits on the asset origination side, which can offset some of that.

<A – Robert Simmons>: And the other thing is with the Cash Optimizer, you're clearly showing rate sensitive people that they can move and get better rates quite easily. You do see some of that going on in the free credit world but what we're seeing is that people that do move to higher rate products end up bringing over additional assets from the outside. So there is some offset benefit there as well. Yes, we're paying on average to that customer a higher rate, but on a much bigger balance.

<Q – Michael Hecht>: Okay, fair enough. Just wanted to also come back on the margin balance to the bank story since it seems – earlier this year you guys were hinting that it was going to happen during the summer and now it sounds more like a 2007 story. So I'm just wondering what...

<A – Mitchell Caplan>: Yes, let me be clear. We would expect to receive approval within two weeks.

<Q – Michael Hecht>: Right. By the time you get implementation and actually get some benefits to spread, it sounds more like an '07 story versus...

<A – Mitchell Caplan>: No. I think we might address the issue as being more of a Q4 issue if we thought that the shape of the yield curve was steeper. But given that the shape of the yield curve is currently inverted, we have chosen not to address any of the benefits in Q4 and we will address them as we go into '07.

<Q – Michael Hecht>: Okay, fair enough. And then just last question, on the asset gathering strategy on the RAA front, I saw you guys close on the Retirement Advisors deal, which I guess is your third or your fourth deal there.

<A – Mitchell Caplan>: Yes.

<Q – Michael Hecht>: Maybe remind us of the strategy there and how it seems to be going so far and when you might be in a position to start breaking out fee revenues on that business so we can monitor how it's going.

<A – Mitchell Caplan>: You know, our goal was to try to acquire I think to be at the end of this year at about, what was it? About 6, I think. So we've now currently announced 3. We have a couple in the pipeline and I suspect that if we believe that it's worth breaking out in '07, then we will, and if not, I guess we'll deal with it in '08. But either way, we'll address it in December when we do the guidance call.

<Q – Michael Hecht>: Okay, sounds good, thanks guys.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you. I will now turn the floor back to Mitchell Caplan for closing remarks.

Mitchell H. Caplan, Chief Executive Officer

That's it. Thanks everybody for joining and sorry the call took so long. See you next quarter.

Operator: Thank you. This concludes today's E*TRADE Financial Corporation third quarter 2006 earnings conference call. You may now disconnect you lines and have a wonderful day.

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