SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2001

Commission file number 1-11921

E*TRADE Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**94-2844166** **(I.R.S. Employer Identification Number)**

4500 Bohannon Drive, Menlo Park, CA 94025
(Address of principal executive offices and zip code)

(650) 331-6000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of October 30, 2001, there were 370,585,687 shares of common stock and 2,017,819 shares exchangeable into common stock outstanding. The Exchangeable Shares, which were issued by EGI Canada Corporation in connection with the acquisition of VERSUS Technologies, Inc. (renamed E*TRADE Technologies Corporation effective January 2, 2001), are exchangeable at any time into common stock on a one-for-one basis and entitle holders to dividend, voting, and other rights equivalent to holders of the registrant's common stock.

E*TRADE GROUP, INC.

FORM 10-Q QUARTERLY REPORT
For the Quarter Ended September 30, 2001

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The page numbers in this Table of Contents reflect actual page numbers, not EDGAR page tag numbers.

References to E*TRADE, Company, “we”, “us” and “our” in this Form 10-Q refer to E*TRADE Group, Inc. and its subsidiaries unless the context requires otherwise.

E*TRADE, the E*TRADE logo, etrade.com, E*TRADE Bank, ClearStation, Equity Edge, Equity Resource, OptionsLink, ShareData, Stateless Architecture, Power E*TRADE, Destination E*TRADE, and TELE*MASTER are trademarks or registered trademarks of E*TRADE Group, Inc. or its subsidiaries in the United States. Some of these and other trademarks are registered outside the United States.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

E*TRADE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Revenues:				
Transaction revenues	$ 76,127	$151,976	$ 316,753	$ 586,766
Interest income	284,946	300,705	900,891	802,678
Global and institutional	37,816	37,185	111,704	127,438
Other	82,467	46,732	218,144	88,392
Gross revenues	481,356	536,598	1,547,492	1,605,274
Interest expense	(189,196)	(195,100)	(614,473)	(506,550)
Provision for loan losses	—	(1,236)	(3,099)	(3,466)
Net revenues	292,160	340,262	929,920	1,095,258
Cost of services	140,519	136,156	433,412	400,317
Operating expenses:				
Selling and marketing	50,268	91,774	199,365	389,703
Technology development	20,882	28,490	66,583	105,617
General and administrative	55,250	61,292	177,398	166,031
Amortization of goodwill and other intangibles	11,421	8,395	28,442	20,600
Acquisition-related expenses	5,387	4,908	5,904	30,640
Facility restructuring and other nonrecurring charges	227,249	—	227,249	—
Total operating expenses	370,457	194,859	704,941	712,591
Total cost of services and operating expenses	510,976	331,015	1,138,353	1,112,908
Operating income (loss)	(218,816)	9,247	(208,433)	(17,650)
Non-operating income (expense):				
Corporate interest income	6,757	5,781	17,755	15,010
Corporate interest expense	(15,297)	(11,355)	(39,284)	(29,503)

Gain (loss) on investments	(32,465)	144,502	(48,038)	179,833
Equity in losses of investments	(1,079)	(5,474)	(6,231)	(7,624)
Unrealized loss on venture funds	(13,506)	(8,099)	(34,075)	(26,189)
Fair value adjustments of financial derivatives	(3,327)	—	(4,703)	—
Other	(422)	(250)	(830)	(1,973)
Total non-operating income (expense)	(59,339)	125,105	(115,406)	129,554
Pre-tax income (loss)	(278,155)	134,352	(323,839)	111,904
Income tax expense (benefit)	(19,471)	87,194	(45,368)	86,172
Minority interest in subsidiaries	299	(499)	(16)	(676)
Income (loss) before extraordinary gain on early extinguishment of debt, net of tax	(258,983)	47,657	(278,455)	26,408
Extraordinary gain on early extinguishment of debt, net of tax (See Note 8)	15,246	—	15,320	—
Net income (loss)	$(243,737)	$ 47,657	$ (263,135)	$ 26,408
Income (loss) per share before extraordinary gain on early extinguishment of debt:				
Basic	$ (0.77)	$ 0.15	$ (0.86)	$ 0.09
Diluted	$ (0.77)	$ 0.15	$ (0.86)	$ 0.09
Net income (loss) per share:				
Basic	$ (0.72)	$ 0.15	$ (0.81)	$ 0.09
Diluted	$ (0.72)	$ 0.15	$ (0.81)	$ 0.09
Shares used in computation of per share data (See Note 13):				
Basic	336,469	309,145	323,833	292,817
Diluted	336,469	322,570	323,833	308,997

See notes to condensed consolidated financial statements.

E*TRADE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	September 30, 2001	September 30, 2000
	(unaudited)	
ASSETS		
Cash and equivalents	$ 1,760,175	$ 433,377
Cash and investments required to be segregated under Federal or other regulations	289,233	125,862
Brokerage receivables—net	2,723,398	6,542,508
Mortgage-backed securities	4,113,210	4,188,553
Loans receivable—net of allowance for loan losses of $13,939 at September 30, 2001 and $10,930 at September 30, 2000	6,301,880	4,172,754
Investments	1,268,499	727,284
Property and equipment—net	332,906	334,262
Goodwill and other intangibles	480,334	484,166
Other assets	759,875	308,671
Total assets	$18,029,510	$17,317,437
LIABILITIES AND SHAREOWNERS' EQUITY		
Liabilities:		

Brokerage payables	$ 2,764,434	$ 6,055,530
Banking deposits	8,027,993	4,721,801
Borrowings by bank subsidiary	3,574,168	3,531,000
Convertible subordinated notes	860,000	650,000
Accounts payable, accrued and other liabilities	1,254,016	471,626
Total liabilities	16,480,611	15,429,957
Company-obligated mandatorily redeemable preferred capital securities of subsidiary trusts holding solely junior subordinated debentures of ETFC (redemption value $57,400)	54,978	30,647
Commitments and contingencies		
Shareowners' equity:		
Preferred stock, shares authorized: 1,000,000; issued and outstanding: none at September 30, 2001 and September 30, 2000	—	—
Shares exchangeable into common stock, $.01 par value, shares authorized: 10,644,223; issued and outstanding: 2,469,926 at September 30, 2001 and 5,619,543 at September 30, 2000	25	56
Common stock, $.01 par value, shares authorized: 600,000,000; issued and outstanding: 327,077,789 at September 30, 2001 and 304,504,764 at September 30, 2000	3,271	3,045
Additional paid-in capital	1,982,872	1,814,581
Unearned Employee Stock Ownership Plan shares	(780)	(1,560)
Shareowners' notes receivable	(31,571)	(19,103)
Deferred stock compensation	(31,087)	—
Accumulated deficit	(268,690)	(6,908)
Accumulated other comprehensive income (loss)	(160,119)	66,722
Total shareowners' equity	1,493,921	1,856,833
Total liabilities and shareowners' equity	$18,029,510	$17,317,437

See notes to condensed consolidated financial statements.

E*TRADE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2001	**2000**
Net cash provided by (used in) operating activities	$ 963,401	$ (63,289)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of mortgage-backed securities, available-for-sale securities, and other investments, net of securities received in business acquisitions	(20,837,789)	(8,763,194)
Proceeds from sales, maturities of and principal payments on mortgage-backed securities, available-for-sale securities, and other investments	21,447,480	6,711,022
Net increase in loans receivable, net of loans received in business acquisitions	(1,482,688)	(1,775,723)
(Increase) decrease in restricted deposits	249	(22,930)
Purchases of property and equipment, net of property and equipment received in business acquisitions	(122,966)	(149,272)
Other	(135,598)	(7,688)
Net cash used in investing activities	(1,131,312)	(4,007,785)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in banking deposits	2,277,784	1,866,753
Advances from the Federal Home Loan Bank of Atlanta	1,175,300	3,758,500

Payments on advances from the Federal Home Loan Bank of Atlanta	(1,765,794)	(2,814,500)
Net increase (decrease) in securities sold under agreements to repurchase	(464,645)	826,841
Net proceeds from convertible subordinated notes	315,250	631,312
Repurchase of subordinated notes, net of issuance costs	(15,283)	—
Proceeds from issuance of trust preferred securities	24,216	—
Proceeds from payments of principal and prepayments of interest on related party loans	2,899	—
Proceeds from issuance of common stock from associate stock transactions	24,189	12,903
Proceeds from bank loans and lines of credit, net of transaction costs	1,967	74,502
Payments on bank loans and lines of credit	(32,867)	(154,802)
Repayment of capital lease obligations	(10,032)	—
Repurchase of shares of common stock	(67,730)	—
Issuance of shareowners' notes receivable	(12,500)	—
Issuance of related party loans receivable	(7,008)	(9,586)
Other	11,976	(13,699)
Net cash provided by financing activities	1,457,722	4,178,224
INCREASE IN CASH AND EQUIVALENTS	1,289,811	107,150
CASH AND EQUIVALENTS—Beginning of period	470,364	326,227
CASH AND EQUIVALENTS—End of period	$ 1,760,175	$ 433,377
SUPPLEMENTAL DISCLOSURES:		
Selected adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation, amortization and discount accretion	$ 117,908	$ 76,719
Non-cash investing and financing activities:		
Unrealized loss on available-for-sale securities	$ (76,296)	$ (444,928)
Tax benefit on exercise of stock options	$ 9,002	$ 22,259
Assets acquired under capital lease obligations	$ 6,358	$ 6,570
Change in financial derivatives recorded at fair market value	$ (251,902)	$ —
Deferred stock compensation, net of amortization	31,087	$ —
Reclassification of loans held for investment to loans held for sale	$ 802,865	$ —
Exchange of 6% convertible subordinated notes for common stock	$ 61,331	$ —
Purchase acquisitions, net of cash acquired:		
Common stock issued and stock options assumed	$ 113,376	$ 92,748
Cash paid, less acquired (including acquisition costs)	2,052	5,790
Liabilities assumed	6,910	17,867
Reduction in payable for purchase of international subsidiary	(20,894)	—
Carrying value of joint venture investment	1,258	715
Fair value of assets acquired (including goodwill of $47,913 and $23,239)	$ 102,702	$ 117,120

See notes to condensed consolidated financial statements.

E*TRADE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include E*TRADE Group, Inc., referred to in this Form 10-Q as the Parent, a financial services holding company, and its subsidiaries, collectively referred to in this Form 10-Q as the Company or E*TRADE. These subsidiaries include, but are not limited to, E*TRADE Securities, Incorporated, referred to in this Form 10-Q as E*TRADE Securities, a securities broker-dealer, TIR (Holdings) Limited, referred to in this Form 10-Q as TIR, a provider of global securities brokerage and other related services to institutional clients, and E*TRADE Financial Corporation, referred to in this Form 10-Q as ETFC, a provider of financial services whose primary business is conducted by its subsidiary, E*TRADE Bank, referred to in this Form 10-Q as the Bank, a federally chartered savings bank that provides deposit accounts insured by the Federal Deposit Insurance Corporation, referred to in this Form 10-Q as the FDIC, to customers nationwide.

On January 22, 2001, the Company changed its fiscal year end from September 30 to December 31.

The unaudited condensed consolidated financial statements of the Company include the accounts of the Parent and its majority owned subsidiaries. Intercompany accounts and transactions are eliminated in consolidation. Entities in which there is at least a 20% ownership or in which there are other indicators of significant influence are generally accounted for by the equity method; those in which there is a less than 20% ownership are generally carried at cost.

These unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, referred to in this Form 10-Q as the SEC, and, in the opinion of management, reflect adjustments consisting only of normal recurring adjustments necessary to present fairly the financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America. These unaudited condensed consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2000.

Certain prior period items in these unaudited condensed consolidated financial statements have been reclassified to conform to the current period presentation.

NOTE 2. FACILITY RESTRUCTURING AND OTHER NONRECURRING CHARGES

On August 29, 2001, the Company announced a restructuring plan aimed at streamlining operations and enhancing profitability primarily by consolidating facilities in the United States and Europe. This restructuring resulted in a pre-tax charge of $227.2 million ($125.2 million after tax) for the three months ended September 30, 2001.

Over the past three years, the Company has completed more than 16 acquisitions of companies with facilities in major metropolitan centers in the United States and Europe. The Company is consolidating some of these facilities to bring together key decision-makers and streamline operations. As part of this initiative, the Company is vacating facilities in Portland, Oregon and San Francisco, California and relocating associates to its facilities in Menlo Park and Rancho Cordova, California and Arlington, Virginia, as well as the soon-to-be-opened E*TRADE Center in San Francisco, California. Also, the Company is combining operations in several international countries and consolidating international back office operations. The Company has recorded a pre-tax restructuring charge of $133.0 million related to its facilities consolidation, representing the undiscounted value of ongoing lease commitments offset by anticipated third party subleases. The charge also includes a pre-tax write-off of leasehold improvements totaling $37.0 million and anticipated operating costs committed in new,

third party sublease property agreements of $42.6 million. The charge does not include relocation costs that will be incurred over the next 12 months and expensed as incurred. The cash outflow related to this action will be paid out over the length of our committed lease terms of 7 to 10 years.

As a result of the Company’s worldwide consolidation activities, certain software developed for specific locations and certain other fixed assets will no longer be used. In addition, management reviewed the Company’s current technology development activities and has chosen to focus on projects generating the highest return in the short term, and as a result, work on less critical projects has ceased. In total, the Company is taking a pre-tax charge of $49.9 million related to writing off capitalized software and hardware related to these technology projects and for other fixed assets.

The restructuring accrual also includes other pre-tax charges of $44.3 million for committed expenses, renegotiation and waiver of certain employment related contractual obligations, termination of consulting agreements and cancellation penalties on various services, that will no longer be required in the facilities the Company is vacating.

A summary of the facility restructuring and other nonrecurring charges is outlined as follows (in thousands):

	Facility Consolidation	Asset Write-Off	Other	Total
Facility restructuring and other nonrecurring charges	$132,999	$49,947	$44,303	$227,249
Activity through September 30, 2001:				
Cash charges	(77)	—	(1,311)	(1,388)
Noncash charges	(43,173)	(45,681)	(18,639)	(107,493)
Restructuring liabilities at September 30, 2001	$ 89,749	$ 4,266	$24,353	$118,368

NOTE 3. BUSINESS COMBINATIONS

In May 2001, the Company entered into an agreement to acquire Web Street, Inc., referred to in this Form 10-Q as Web Street, parent company of Web Street Securities, Inc., referred to in this Form 10-Q as Web Street Securities, an online brokerage firm, for an aggregate preliminary purchase price of approximately $48.5 million, comprised of approximately 4.9 million shares of the Company’s common stock valued at $43.5 million, the assumption of approximately 418,000 warrants valued at approximately $700,000, and acquisition costs of approximately $4.3 million. Through the acquisition of Web Street, the Company increased its customer base. As of June 30, 2001, the Company obtained a controlling interest in Web Street, and the Company completed the acquisition of all of its outstanding shares by August 6, 2001. The acquisition was accounted for using the purchase method of accounting, and the results of Web Street's operations have been combined with those of the Company from the date of acquisition. The purchase price exceeded the fair value of the tangible assets acquired by approximately $37.2 million, which has been allocated to active brokerage accounts acquired. The value allocated to active brokerage accounts acquired will be amortized over seven years using an accelerated method. The purchase price allocation at September 30, 2001 is preliminary and has been allocated based on the estimated fair value of net tangible and intangible assets acquired.

On February 1, 2001, the Company acquired LoansDirect, Inc., which, on June 15, 2001, was merged into and renamed E*TRADE Mortgage Corporation, referred to in this Form 10-Q as E*TRADE Mortgage, an alternative distribution mortgage originator, for an aggregate purchase price of approximately $36.6 million, comprised of approximately 3.0 million shares of the Company's common stock valued at $33.0 million, the assumption of vested employee stock options of approximately $1.5 million, and acquisition costs of approximately $2.1 million. Through the acquisition of E*TRADE Mortgage, the Company expects to make

strategic inroads into the consumer lending market, advancing its diversified online financial services model. The acquisition was accounted for using the purchase method of accounting, and the results of E*TRADE Mortgage's operations have been combined with those of the Company since the date of acquisition. The purchase price exceeded the fair value of the assets acquired by approximately $32.6 million, which was recorded as goodwill to be amortized over 15 years. The purchase price allocation at September 30, 2001 is preliminary and has been allocated based on the estimated fair value of net tangible and intangible assets acquired. Prior period results for E*TRADE Mortgage were not material. Included in other revenue, the Company recorded $28.3 million and $62.3 million in the three and nine months ended September 30, 2001, respectively, from the gains on the sales of loans originated by E*TRADE Mortgage (gains on the sales of loans held for sale by the Bank in the aggregate were $46.5 million and $88.6 million in the three and nine months ended September 30, 2001, respectively). Gains or losses resulting from sales of mortgage loans are recognized at the date of settlement and are based on the difference between the cash received and the carrying value of the related loans sold less related transaction costs. Nonrefundable fees and direct costs associated with the origination of mortgage loans are deferred and recognized when the related loans are sold.

The proforma information below assumes that the acquisitions of Web Street and E*TRADE Mortgage occurred at the beginning of calendar year 2000 and includes the effect of amortization of goodwill and the amount allocated to active brokerage accounts acquired from that date (in thousands, except per share amounts):

	Nine Months Ended September 30,	
	2001	**2000**
Net revenues	$ 941,971	$1,137,394
Income (loss) before extraordinary gains	$(292,190)	$ 910
Net income (loss)	$(276,870)	$ 1,835
Basic and diluted income (loss) per share before extraordinary gains	$ (0.88)	$ 0.00
Basic and diluted income (loss) per share	$ (0.83)	$ 0.01

The proforma information is for information purposes only and is not necessarily indicative of the results of future operations nor results that would have been achieved had the acquisition taken place at the beginning of calendar year 2000.

In October 2000, the Company completed the acquisition of PrivateAccounts, Inc., renamed E*TRADE Advisory Services, Inc. on March 26, 2001, and referred to in this Form 10-Q as E*TRADE Advisory Services, a Minneapolis-based developer of online separately managed accounts. The Company issued 618,057 shares of common stock valued at approximately $8.7 million in exchange for all of the outstanding shares of E*TRADE Advisory Services. The Company also issued an equal number of shares to be held in escrow until the completion of product and asset target milestones, whereby the Company would be required to issue up to an additional $31.0 million of the Company's common stock and, if necessary, cash consideration as incentive consideration. In March 2001, E*TRADE Advisory Services achieved a product development milestone, resulting in the release from escrow of approximately 479,000 shares valued at approximately $4.3 million. In July 2001, E*TRADE Advisory Services achieved a second product development milestone, resulting in the release from escrow of approximately 140,000 shares and the issuance of approximately 557,000 additional shares valued in total at $4.3 million. The acquisition was accounted for using the purchase method of accounting, and the results of E*TRADE Advisory Services' operations have been combined with those of the Company since the date of acquisition. The purchase price allocation has been allocated based on the estimated fair value of net tangible and intangible assets acquired. Prior period results for E*TRADE Advisory Services were not material.

In October 1999, the Company entered into a joint venture agreement with Berliner Effektenbank AG and New York Broker Deutschland AG to form E*TRADE Germany AG, referred to in this Form 10-Q as E*TRADE Germany. The Company had a 60% ownership interest in this joint venture at September 30, 2000. The Company entered into an agreement to acquire the remaining 40% ownership interest in E*TRADE

Germany for approximately 24.0 million Euros (approximately $20.2 million as of October 16, 2000, the closing date of the transaction). The additional investment was comprised of approximately $1.4 million in cash (paid in October 2000), 1.4 million shares of the Company's common stock valued at approximately $12.3 million (paid in January 2001), and 1.4 million shares of the Company's common stock valued at approximately $8.7 million (paid in July 2001). The purchase price exceeded the fair value of the assets acquired by $19.4 million, which was recorded as goodwill to be amortized over 20 years. The acquisition was accounted for using the purchase method of accounting, and the results of E*TRADE Germany's operations have been combined with those of the Company since the date of the acquisition. The purchase price allocation has been allocated based on the estimated fair value of net tangible assets acquired. Prior period results for E*TRADE Germany were not material.

NOTE 4. SALE OF INTERNATIONAL SUBSIDIARY

In November 2000, the Company sold its ownership interest in E*TRADE @ Net Bourse S.A. for approximately 80.5 million Euros (approximately $68.0 million as of November 2000, the date of the transaction). Of this amount, approximately 8.2 million Euros (approximately $7.0 million as of November 2000, the date of the transaction) will be held in escrow for two years, of which 50% may be released after one year. In conjunction with this transaction, the Company reacquired its licensing rights to France, as well as the ownership interests in E*TRADE SARL, E*TRADE Italy and E*TRADE Benelux, previously held by E*TRADE @ Net Bourse S.A. No gain or loss resulted from this transaction.

NOTE 5. BROKERAGE RECEIVABLES—NET AND PAYABLES

Brokerage receivables—net and payables consist of the following (in thousands):

	September 30, 2001	September 30, 2000
Receivable from customers and non-customers (less allowance for doubtful accounts of $5,659 at September 30, 2001 and $3,887 at September 30, 2000)	$1,900,647	$5,173,220
Receivable from brokers, dealers and clearing organizations:		
Net settlement and deposits with clearing organizations	87,694	89,031
Deposits paid for securities borrowed	719,678	1,267,109
Securities failed to deliver	903	1,970
Other	14,476	11,178
Total brokerage receivables—net	$2,723,398	$6,542,508
Payable to customers and non-customers	$1,808,245	$1,735,228
Payable to brokers, dealers and clearing organizations:		
Deposits received for securities loaned	912,712	4,296,399
Securities failed to receive	1,550	6,266
Other	41,927	17,637
Total brokerage payables	$2,764,434	$6,055,530

Receivable from and payable to brokers, dealers and clearing organizations result from the Company's brokerage activities. Receivable from customers and non-customers represents credit extended to customers and non-customers to finance their purchases of securities on margin. At September 30, 2001 and September 30, 2000, credit extended to customers and non-customers with respect to margin accounts was $1,475 million and $5,040 million, respectively. Securities owned by customers and non-customers are held as collateral for amounts due on margin balances, the value of which is not reflected in the accompanying consolidated balance sheets. As of September 30, 2001, the Company has received collateral primarily in connection with securities

borrowed and customer margin loans with a market value of $2,879 million, which it can sell or repledge. Of this amount, $1,055 million has been pledged or sold as of September 30, 2001 in connection with securities loans, bank borrowings and deposits with clearing organizations. Payable to customers and non-customers represents free credit balances and other customer and non-customer funds pending completion of securities transactions. The Company pays interest on certain customer and non-customer credit balances.

NOTE 6. INVESTMENTS

Investments are comprised of trading and available-for-sale debt and equity securities, as defined under the provisions of Statement of Financial Accounting Standard, referred to in this Form 10-Q as SFAS, No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Also included are investments in entities in which the Company owns between 20% and 50%, or in which there are other indicators of significant influence. These investments are generally accounted for using the equity method. Investments in which there is a less than 20% ownership are generally carried at cost.

The carrying amounts of investments are shown below (in thousands):

	September 30, 2001	September 30, 2000
Trading securities	$ 51,758	$ 3,867
Available-for-sale investment securities(1)	1,132,305	603,500
Equity method and other investments:		
Joint ventures	16,515	30,492
Venture capital funds	27,000	50,974
Archipelago	25,274	25,658
Other investments	15,647	12,793
Total investments	$1,268,499	$727,284

(1) Includes investments of $8.0 million and $18.1 million at September 30, 2001 and 2000, respectively, in mutual funds in which the Company is the sponsor.

Publicly-Traded Equity Securities

Included in available-for-sale securities are investments in several companies that are publicly-traded and carried at fair value. In June 2001, the

Company determined there had been an other than temporary decline in the value of its technology stocks, given market conditions combined with a sustained decline in the value of some of its publicly traded equities in technology companies during the six months ended June 30, 2001. As a result, the Company wrote down the related investments to their fair market value at June 30, 2001, recognizing pre-tax losses of approximately $9.3 million in the three months ended June 30, 2001. The Company reviews its portfolio of publicly-traded and other securities on a quarterly basis for indications of possible impairment. Declines in value assessed as other than temporary are reflected in loss on investments. Unrealized gains related to available-for-sale securities were none and $186.3 million at September 30, 2001 and 2000, respectively. Unrealized losses related to these investments were $1.7 million and $2.8 million at September 30, 2001 and 2000, respectively.

Joint Ventures

During the three months ended September 30, 2001, the Company determined that, based on projected cash flows, its investment in eAdvisor was impaired. The Company recognized a $10.0 million impairment loss on its investment in the three months ended September 30, 2001.

SoundView Technology Group, Inc.

At September 30, 2000, E*TRADE owned a 23.6% investment in E*OFFERING Corp., referred to in this Form 10-Q as E*OFFERING, a full service, Internet-based investment bank. On October 16, 2000, SoundView Technology Group, Inc., formerly known as Wit SoundView Group, Inc., referred to in this Form 10-Q as Wit, completed the acquisition of E*OFFERING. Under the terms of the E*OFFERING acquisition agreement, the

Company received approximately 5.0 million shares of Wit common stock and warrants to purchase approximately 535,000 and 1.8 million shares of Wit common stock exercisable immediately for $5.99 and $0.60 per share, respectively, and expiring in February 2001 and January 2005, respectively, as well as the right to name one representative to Wit's Board of Directors. The warrants to purchase approximately 535,000 shares of Wit common stock expired unexercised in February 2001 and the Company did not exercise any of the warrants to purchase approximately 1.8 million shares. Concurrently with this agreement, the Company and Wit entered a Strategic Alliance Agreement with Wit, referred to in this Form 10-Q as the Strategic Alliance Agreement. Pursuant to the terms of the Strategic Alliance Agreement, the Company acquired Wit's retail brokerage business, received approximately 4.0 million shares of Wit common stock and a warrant to purchase up to 2.0 million shares of Wit common stock for $10.25 per share as consideration for naming Wit to be the exclusive source of initial public offerings and entering into certain arrangements concerning follow-on offerings, investment banking products and secondary market-making services. The Strategic Alliance Agreement had a total term of five years. The fair value of the consideration for the Strategic Alliance Agreement was recorded as deferred revenue and amortized to other revenue over the term of the Strategic Alliance Agreement. In a related transaction, the Company also purchased 2.0 million shares of Wit common stock for $20.5 million in cash. The Company subsequently purchased 300,000 shares of Wit common stock for approximately $1.9 million on the open market. As a result of these transactions, the Company held an approximate 10% ownership interest in Wit, and accounted for its investment under the equity method.

Effective August 20, 2001, the Company entered into a Termination Agreement and General Release with Wit, referred to in this Form 10-Q as the Termination Agreement. Pursuant to the terms of the Termination Agreement, the Company and Wit terminated the Strategic Alliance Agreement in its entirety and entered into a new business relationship. In consideration of the Termination Agreement, the Company transferred to Wit 9.3 million shares of Wit common stock, warrants to purchase 1.8 million shares of Wit common stock at a price of $0.60 per share, and warrants to purchase 2.0 million shares of Wit common stock at $10.25 per share. The fair value of the shares and warrants transferred to Wit was $16.5 million, which has been recorded as a reduction to other revenues, offsetting the recognition of $17.8 million in remaining deferred revenues relating to the termination of the Company's Strategic Alliance Agreement. Subsequent to entering into the Strategic Alliance Agreement, the Company sold its remaining investment in Wit, comprised of 2.3 million shares of Wit common stock to a related party at fair market value for cash of $3.8 million. The Company recognized a $19.8 million loss on its investment in Wit, reflecting the difference between the fair value and the carrying value of the securities as of the date of these transactions.

Other

The Company has also made investments in non-public, venture capital-backed high technology companies with which it does business and which provide Internet-based services. These investments represent less than 20% of the outstanding shares of these companies and are accounted for under the cost method. The Company also has investments in venture funds which are accounted for under the equity method. The Company amended its partnership agreement in the E*TRADE eCommerce Fund, L.P., recording an $11.1 million unrealized loss and a corresponding reduction in the Company's investment in the fund in the three months ended September 30, 2001.

NOTE 7. RELATED PARTY TRANSACTIONS

In September 2001, following the events of September 11, 2001, the Company made a short-term loan to a director of the Company in the aggregate principal amount of approximately $4.1 million. The loan accrued interest at a rate of 3.82% annually. The principal amount and accrued interest on the loan were repaid in full in October 2001. The loan was collateralized by shares of common stock currently held in the name of the director.

In May 2001, the Company made a loan to an executive officer of the Company in the aggregate principal amount of $2.0 million. The loan accrued interest at a rate of 4.25% annually. The principal amount and accrued interest on the loan were due in May 2002 and were repaid in full in October 2001. The loan was collateralized by real property owned by the executive officer.

In March 2001, the Company made a loan to an executive officer of the Company in the aggregate principal amount of $0.1 million. The loan accrues interest at a rate of 4.68% annually. Accrued interest on the loan is due in March 2002, and the remaining interest and principal are due in March 2003. The loan is collateralized by shares of the Company's common stock currently held in the name of the executive officer.

In November and December 2000, the Company made loans to two executive officers and a director of the Company in the aggregate principal amount of $30.5 million. The loans accrue interest at rates of between 6.09% and 6.10% annually. The principal amounts of $0.5 million, $15.0 million, and $15.0 million are due in December, 2002, November, 2005 and November, 2010, respectively. One of the $15.0 million loans is collateralized by real property owned by an executive officer. The other $15.0 million loan is collateralized by equity interests in various limited liability companies and properties owned by a director. In connection with the Company's facility restructuring and other nonrecurring charges in the three months ended September 30, 2001, the Company renegotiated and obtained a waiver of certain significant contractual obligations in consideration of settlement of the outstanding $15.0 million loan secured by real estate.

In connection with certain corporate actions in the three months ended September 30, 2001, the Company renegotiated and terminated certain consulting relationships with certain former executive officers of the Company. As partial consideration for the termination of these agreements, the Company settled a total of $3.3 million in loans to the executive officers.

Related party loans receivable are recorded in other assets ($26.3 million at September 30, 2001 and $9.9 million at September 30, 2000).

See Note 10 for additional related party transactions.

NOTE 8. SUBORDINATED NOTES AND OTHER BORROWINGS

The Company recorded an extraordinary gain on early extinguishment of debt of $15.2 million (net of tax expense of $10.2 million) and $15.3 million (net of tax expense of $10.8 million) in the three and nine months ended September 30, 2001, respectively. In the three months ended September 30, 2001, amounts recorded included a $16.9 million gain (net of tax expense of $11.3 million) on exchanges in the aggregate of $60.0 million of the Company’s 6% convertible subordinated notes for approximately 6.4 million shares of the Company’s common stock and repurchases in the aggregate of $25.0 million of the Company’s 6% convertible subordinated notes for approximately $15.3 million paid in cash, offset by a $1.7 million loss (net of tax benefit of $1.1 million) recorded as a result of the early redemption of $227.0 million of adjustable and fixed rate advances from the Federal Home Loan Bank of Atlanta, referred to in this Form 10-Q as the FHLB. In the nine months ended September 30, 2001, amounts recorded included a $22.0 million gain (net of tax expense of $14.7 million) on exchanges in the aggregate of $90.0 million of the Company’s 6% convertible subordinated notes for approximately 9.2 million shares of the Company’s common stock and repurchases in the aggregate of $25.0 million of the Company’s 6% convertible subordinated notes for approximately $15.3 million paid in cash, offset by a $6.7 million loss (net of tax benefit of $3.9 million) recorded as a result of the early redemption of $827.0 million of adjustable and fixed rate advances from the FHLB. The FHLB advances were entered into as a result of normal funding requirements of the Company’s banking operations. The loss consisted primarily of prepayment penalties and costs associated with these early redemptions.

On May 29, 2001, the Company completed a Rule 144A offering of $325 million of convertible subordinated notes due May 2008. The notes are convertible, at the option of the holder, into a total of approximately 29.7 million shares of the Company’s common stock at a conversion price of $10.925 per share. The notes bear interest at 6.75%, payable semiannually, are non-callable for three years and may then be called by the Company at a premium, which declines over time. The holders have the right to require redemption at a premium in the event of a change in control or other defined redemption event. The Company expects to use the net proceeds for general corporate purposes, including capital expenditures and to meet working capital needs.

The Company has not identified the amounts planned to be spent on each of these areas or the timing of such expenditures. Accordingly, the Company’s management will have broad discretion in the application of the net proceeds. Debt issuance costs of $10.5 million are included in other assets and are being amortized to interest expense over the term of the notes. Had these securities been issued at the beginning of the calendar year, the additional interest expense and issuance costs associated with the securities would have had no effect on the reported basic and diluted net loss per share of $0.72 for the three months ended September 30, 2001 and would have increased the basic and diluted net loss per share to $0.83 for the nine months ended September 30, 2001.

During the nine months ended September 30, 2001, the Company obtained term loans from financial institutions which are collateralized by equipment owned by the Company. Borrowings under these term loans bear interest at 3.0% to 3.25% above LIBOR (5.637% to 5.887% at September 30, 2001). The Company had $14.7 million outstanding under these term loans at September 30, 2001, which is included in accounts payable, accrued and other liabilities.

In October 2001, the Company renewed a $50 million line of credit under an agreement with a bank that expires in December 2001. The line of credit is collateralized by investment securities that are owned by the Company. Borrowings under the line of credit bear interest at 0.35% above LIBOR (total of 2.987% at September 30, 2001). The Company had no borrowings outstanding under this line of credit at September 30, 2001.

NOTE 9. MANDATORILY REDEEMABLE PREFERRED SECURITIES

In July 2001, ETFC formed ETFC Capital Trust I, referred to in this Form 10-Q as ETFCCT I, a business trust formed solely for the purpose of issuing capital securities. ETFCCT I sold, at par, 20,000 shares of Floating Rate MMCapS, with a liquidation amount of $1,000 per capital security, for a total of $20.0 million and invested the net proceeds in ETFC’s Floating Rate Junior Subordinated Debentures. The Subordinated Debentures mature in 2031 and have a variable annual dividend rate at 3.75% above the 6 month LIBOR, payable semi-annually, beginning in January 2002. The net proceeds were used for ETFC’s general corporate purposes, which include funding ETFC’s continued growth.

In July 2001, ETFC formed ETFC Capital Trust II, referred to in this Form 10-Q as ETFCCT II, a business trust formed solely for the purpose of issuing capital securities. ETFCCT II sold, at par, 5,000 shares of Fixed Rate MMCapS, with a liquidation amount of $1,000 per capital security, for a total of $5.0 million and invested the net proceeds in ETFC’s Fixed Rate Junior Subordinated Debentures. The Subordinated Debentures mature in 2031 and have an annual dividend rate of 10.25%, payable semi-annually, beginning in January 2002. The net proceeds were used for ETFC’s general corporate purposes, which include funding ETFC’s continued growth.

NOTE 10. SHAREOWNERS’ EQUITY

Stock Repurchase Program

In September 2001, the Company's Board of Directors approved a multi-year stock buyback program authorizing the Company to repurchase up to 50.0 million shares of the Company's common stock. In the three months ended September 30, 2001, approximately 10.1 million shares of common stock were repurchased for an aggregate purchase price of approximately $52.2 million. These purchases were made in the period from September 17, 2001 through September 28, 2001 in accordance with the terms of the Emergency Orders Pursuant to Section 12(k)(2) of the Securities Exchange Act issued by the SEC beginning September 14, 2001. Pursuant to the stock buyback program approved by the Board, the Company remains authorized to repurchase up to 39.9 million additional shares of common stock.

Share Buyback

In August 2001, the Company reacquired approximately 7.0 million shares of the Company's common stock in a private transaction valued at approximately $38.0 million. The Company has retired these shares.

Shareowners' Notes Receivable

Outstanding shareowners' notes receivable in the aggregate of $19.1 million were due through July 2001. The terms of these notes have been extended through December 31, 2002, and the interest rates have been adjusted to reflect current market rates.

In June 2001, the Company made a full recourse loan to one of its executive officers for approximately $12.5 million. The proceeds from this loan were primarily used to fund the purchase of shares of the Company's common stock and the associated tax liability for the exercise and hold of stock options. The loan accrues interest at the rate of 7.5% per annum. The interest on the loan is due in June 2002 with all remaining unpaid interest due upon the payment of the principal balance in July 2002.

In December 2000, the Company made a full recourse loan to one of its executive officers for approximately $0.5 million. The proceeds from this loan were used to fund the purchase of shares of the Company's common stock for the exercise and hold of stock options. The loan accrues interest at the rate of 6.15% per annum. The interest on the loan is due in December 2001 with all remaining unpaid interest due upon the payment of the principal in January 2002.

Deferred Stock Compensation

In April 2001, in connection with the issuance of restricted common stock to an executive officer of the Company, the Company recorded deferred stock compensation of $24.4 million, the fair market value of the shares on the date of grant. This amount is being amortized to expense ratably over five years, the period in which restrictions are removed on the related shares of restricted common stock.

In January 2001, in connection with the issuance of restricted common stock to certain executive officers, the Company recorded deferred stock compensation of $14.5 million, the fair market value of the shares on the date of grant. This amount is being amortized to expense ratably over the period in which restrictions are removed on the related shares of restricted common stock, generally four years.

Amortization of deferred stock compensation for the three and nine months ended September 30, 2001 was $2.6 million and $6.6 million, respectively.

NOTE 11. ASSOCIATE BENEFIT PLAN

Effective January 1, 2001, the Company's Board of Directors adopted a Supplemental Executive Retirement Plan, referred to in this Form 10-Q as the SERP, for certain executive officers. The purpose of the SERP is to attract, retain and motivate certain executive officers of the Company who provide valuable services to the Company and to provide those officers with flexibility to meet their retirement and estate planning needs. Funding of the SERP by the Company is discretionary. Contributions to the SERP, if any, are due at the beginning of each calendar year and are deposited into a Rabbi Trust, to which the Company retains ownership until participant benefits vest and are distributed. To receive full benefits accrued under the SERP, at the time of retirement a participating individual must have fifteen years of participation in the plan. With the exception of the Company's Chief Executive Officer, whose benefits vest immediately, no portion of a participant's benefits will become vested unless the individual has participated in the plan for at least five years. Fifty percent of participation benefits vest after five years of participation in the SERP with the remaining benefits vesting over the next five years of participation. In January 2001, the Company contributed $12.1 million to fund its SERP

obligations and will recognize related compensation expense over the vesting period for participating individuals. The Company recognized $470,000 and $10.6 million in compensation expense related to the SERP during the three and nine months ended September 30, 2001, respectively. Of the amounts recognized in the nine months ended September 30, 2001, $9.6 million was a nonrecurring charge.

NOTE 12. COMPREHENSIVE LOSS

The reconciliation of net income (loss) to comprehensive loss is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Net income (loss)	$(243,737)	$47,657	$(263,135)	$ 26,408
Changes in other comprehensive loss:				
Unrealized gain (loss) on available-for-sale securities, net of tax	66,386	(47,796)	51,176	(213,873)
Reclassification as a result of realized (gains) losses on available-for-sale securities	(8,491)	(44,069)	(41,216)	(68,263)
Unrealized loss on derivative instruments, net of tax (see Note 17)	(92,730)	—	(117,541)	—
Reclassification of SFAS 133 adjustments	(2,342)	—	8,568	—
Cumulative translation adjustments	816	(479)	(3,204)	(1,338)
Total comprehensive loss	$(280,098)	$(44,687)	$(365,352)	$(257,066)

NOTE 13. NET INCOME (LOSS) PER SHARE

The following table sets forth the computation of the numerator and denominator used to compute basic and diluted income (loss) per share before extraordinary gains and net income (loss) per share (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2001	2000	2000	2001	2000	2000
	Basic and diluted loss per share	Basic income per share	Diluted income per share	Basic and diluted loss per share	Basic income per share	Diluted income per share
Numerator:						
Income (loss) before extraordinary gain on early extinguishment of debt	$(258,983)	$ 47,657	$ 47,657	$(278,455)	$ 26,408	$ 26,408
Extraordinary gain on early extinguishment of debt, net of tax	15,246	—	—	15,320	—	—
Net income (loss)	$(243,737)	$ 47,657	$ 47,657	$(263,135)	$ 26,408	$ 26,408
Denominator:						
Weighted average shares outstanding	336,469	309,145	309,145	323,833	292,817	292,817
Dilutive effect of options issued to associates	—	—	12,596	—	—	15,291
Dilutive effect of warrants outstanding	—	—	829	—	—	889
	336,469	309,145	322,570	323,833	292,817	308,997

Because the Company reported a net loss for the three and nine months ended September 30, 2001, the calculation of diluted net loss per share does not include common stock equivalents as they are anti-dilutive and would result in a reduction of net loss per share. If the Company had reported net income for the three and nine months ended September 30, 2001, there would have been 3.2 million and 6.8 million additional shares for options outstanding, respectively, and 198,000 additional shares for warrants outstanding. Excluded from the calculation of diluted net income (loss) per share are approximately 54.7 million and 40.2 million shares of common stock issuable under convertible subordinated notes for the three and nine months ended September 30, 2001, respectively, and 27.5 million and 20.4 million shares of common stock issuable under convertible subordinated notes for the three and nine months ended September 30, 2000, respectively. These shares have been excluded from the calculation as the effect of applying the treasury stock method on an as-if-converted basis would be anti-dilutive in the calculation of diluted net income (loss) per share.

The following options to purchase shares of common stock have not been included in the computation of diluted net income (loss) per share because the options' exercise price was greater than the average market price of the Company's common stock for the periods presented, and therefore, the effect would be anti-dilutive (in thousands, except exercise price data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Options excluded from computation of diluted net income (loss) per share	33,237	13,650	18,656	11,927
Exercise price ranges:				
High	$ 58.19	$ 58.75	$ 58.19	$ 58.75
Low	$ 6.00	$ 17.28	$ 8.20	$ 20.59

NOTE 14. REGULATORY REQUIREMENTS

E*TRADE Securities is subject to the Uniform Net Capital Rule, referred to in this Form 10-Q as the Rule, under the Securities Exchange Act of 1934 administered by the SEC and the National Association of Securities Dealers Regulation, Inc., referred to in this Form 10-Q as the NASDR, which requires the maintenance of minimum net capital. E*TRADE Securities has elected to use the alternative method permitted by the Rule, which requires that E*TRADE Securities maintain minimum net capital equal to the greater of $250,000 or two percent of aggregate debit balances arising from customer transactions, as defined. E*TRADE Securities had amounts in relation to the Rule as follows (in thousands, except percentage data):

	September 30, 2001	September 30, 2000
Net capital	$295,918	$479,036
Percentage of aggregate debit balances	18.2%	9.2%
Required net capital	$ 32,503	$103,747
Excess net capital	$263,415	$375,289

Under the alternative method, a broker-dealer may not repay subordinated borrowings, pay cash dividends or make any unsecured advances or loans to its parent or employees if such payment would result in net capital of less than 5% of aggregate debit balances or less than 120% of its minimum dollar amount requirement.

The table below summarizes the required minimum and excess capital amounts for the Company's other U.S. broker-dealer subsidiaries (in thousands):

	September 30, 2001			September 30, 2000		
	Required Net Capital	Net Capital	Excess Net Capital	Required Net Capital	Net Capital	Excess Net Capital
E*TRADE Institutional Securities, Inc.	$258	$ 3,289	$ 3,031	$250	$ 1,161	$ 911
E*TRADE Investor Select, Inc.	$ 5	$ 5	$ —	$ 5	$ 351	$ 346
Marquette Securities, Inc.	$250	$ 500	$ 250	$250	$ 536	$ 286
E*TRADE Global Asset Management, Inc.	$630	$12,140	$11,510	$113	$21,774	$21,661
E*TRADE Canada Securities Corporation	$100	$ 295	$ 195	$100	$ 233	$ 133
Web Street Securities and subsidiary.	$817	$ 2,451	$ 1,634	Not Applicable	Not Applicable	Not Applicable

The Company's broker-dealer subsidiaries located in Canada, South Africa, Australia, Europe, and South East Asia, have various and differing capital requirements, all of which were met at September 30, 2001 and 2000. The aggregate net capital, required net capital, and excess net capital of these companies at September 30, 2001 was $80.7 million, $30.3 million, and $50.4 million, respectively. The aggregate net capital, required net capital, and excess net capital of these companies at September 30, 2000 was $48.4 million, $18.5 million, and $29.9 million, respectively.

The Bank is also subject to various regulatory capital requirements administered by the federal banking agencies.

Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. Management believes that, as of September 30, 2001 the Bank has met all capital adequacy requirements to which it was subject. As of September 30, 2001 and 2000, the Bank had capital levels that met the requirements for a well capitalized savings association under the regulatory framework for prompt corrective action adopted by the Office of Thrift Supervision, referred to in this Form 10-Q as the OTS. To qualify as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. There are no conditions or events since September 30, 2001 that management believes have changed the institution's capital levels.

The Bank's required and actual capital amounts and ratios are presented in the table below (dollars in thousands):

	Actual		Required for Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2001:						
Core Capital (to adjusted tangible assets)	$777,589	6.0%	>$519,472	>4.0%	>$649,340	>5.0%
Tangible Capital (to tangible assets)	$777,589	6.0%	>$194,802	>1.5%	N/A	N/A
Tier I Capital (to risk weighted assets)	$777,589	11.2%	N/A	N/A	>$415,256	>6.0%
Total Capital (to risk weighted assets)	$791,455	11.4%	>$533,674	>8.0%	>$692,093	>10.0%
As of September 30, 2000:						
Core Capital (to adjusted tangible assets)	$582,058	6.5%	>$359,874	>4.0%	>$449,843	>5.0%
Tangible Capital (to tangible assets)	$582,058	6.5%	>$134,953	>1.5%	N/A	N/A
Tier I Capital (to risk weighted assets)	$582,058	16.8%	N/A	N/A	>$207,890	>6.0%
Total Capital (to risk weighted assets)	$592,597	17.1%	>$277,186	>8.0%	>$346,483	>10.0%

NOTE 15. COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS

In the ordinary course of its business, the Company engaged in certain stock loan transactions with MJK Clearing, Inc., referred to in this Form 10-Q as MJK, involving the lending of Nasdaq-listed common stock of GenesisIntermedia, Inc., referred to in this Form 10-Q as GENI and other securities from MJK to the Company. Subsequently, the Company relent the GENI securities received from MJK to three other broker/dealers, Wedbush Morgan Securities, referred to in this Form 10-Q as Wedbush, Nomura Securities, Inc., referred to in this Form 10-Q as Nomura, and Fiserv Securities, Inc., referred to in this Form 10-Q as Fiserv. On September 25, 2001, Nasdaq halted trading in the stock of GENI, which had last traded at a price of $5.90 before the halt. As a result, MJK was unable to meet its collateral requirements on the GENI and other securities with certain counterparties to those transactions. MJK was ordered to cease operations by the SEC because they failed to meet regulatory capital requirements, and was placed into SIPC liquidation in the District of Minnesota. These events have led to disputes among several of the participants in the stock loan transactions involving the stock of GENI and other securities lent by MJK regarding which entities should bear the losses resulting from MJK's insolvency. The Company is confident that E*TRADE Securities has sufficient capital in excess of regulatory requirements to cover any potential exposure arising from these matters.

The Company has worked with the participants and regulatory agencies to resolve these disputes, but to date the disputes have not been resolved. Wedbush, Nomura, and Fiserv have commenced separate legal actions against the Company. These actions seek various forms of equitable relief and seek repayment of a total of approximately $60.0 million received by the Company in connection with the GENI and other transactions described above. The Company believes that the plaintiffs must look to MJK as the debtor for repayment, and that it has defenses in each of these actions and will vigorously defend itself in all matters. To date, the Company has successfully defeated all actions for interim relief or has entered into consent orders essentially maintaining the status quo between the parties until the matter can be judicially resolved. Because the litigation is in its early stages, the Company is unable to predict the ultimate outcome or the amount of any potential losses.

In the normal course of business, the Bank makes various commitments to extend credit and incurs contingent liabilities that are not reflected in the accompanying consolidated balance sheets. As of September 30, 2001, the Bank had commitments to purchase or originate $682.8 million in fixed rate and $207.9 million in variable rate loans and certificates of deposit scheduled to mature in less than one year approximating $2.5 billion.

The Company is a defendant in civil actions arising in the normal course of business. These currently include, among other actions, putative class actions alleging various causes of action for "unfair or deceptive business practices" that were filed against the Company between November 21, 1997 and March 11, 1999, as a result of various systems interruptions that the Company previously experienced.

To date, none of these putative class actions has been certified, and the Company believes that these claims are without merit and intends to defend against them vigorously. An unfavorable outcome in any of these matters for which the Company's pending insurance claims are rejected could harm the Company's business. From time to time, the Company has been threatened with, or named as a defendant in, lawsuits, arbitrations and administrative claims. Compliance and trading problems that are reported to regulators such as the SEC or the NASDR by dissatisfied customers or others are investigated by such regulators, and may, if pursued, result in formal arbitration claims being filed against the Company by customers and/or disciplinary action being taken against the Company by regulators. Any such claims or disciplinary actions that are decided against the Company could harm the Company's business. The Company is also subject to periodic regulatory audits and inspections.

The securities and banking industries are subject to extensive regulation under federal, state and applicable international laws. As a result, the Company is required to comply with many complex laws and rules and its ability to so comply is dependent in large part upon the establishment and maintenance of a qualified compliance system.

The Company maintains insurance in such amounts and with such coverage, deductibles and policy limits as management believes are reasonable and prudent. The principal risks that the Company insures against are comprehensive general liability, commercial property damage, hardware/software damage, directors and officers, Fidelity (crime) Bond, and errors and omissions and employment practices liability. The Company believes that such insurance coverage is adequate for the purpose of its business.

The Company has entered into management continuity agreements with its key executive officers. These management continuity agreements provide for annual base salary compensation, stock option acceleration and severance payments in the event of termination of employment under defined circumstances within 18 months following a change in the Company's control. Base salaries are subject to adjustments according to the individual's and the Company's financial performance.

NOTE 16. SEGMENT INFORMATION

Segment Information

The Company has separated its financial services into four categories: domestic retail brokerage, banking, global and institutional, and asset gathering and other. As a result of acquisitions, beginning in the three months ended March 31, 2001, the banking segment includes the operations of E*TRADE Mortgage and beginning in the three months ended June 30, 2001, the domestic retail brokerage and other segment includes Web Street (see Note 3). There have been no other changes to these categories from fiscal 2000. As the asset gathering and other operations business represents emerging activities which are not material to the consolidated results for segment reporting purposes, management has aggregated asset gathering and other with domestic retail brokerage to form one of three reportable segments, with banking and global and institutional comprising the other two segments currently considered by management when it evaluates Company performance.

Financial information for the Company's reportable segments is presented in the table below, and the totals are equal to the Company's consolidated amounts as reported in the unaudited condensed consolidated financial statements (in thousands):

	Domestic Retail Brokerage & Other	Banking	Global and Institutional	Total
Three Months Ended September 30, 2001:				
Interest income—net of interest expense	$ 52,270	$ 41,346	$ 2,134	$ 95,750
Non-interest revenue—net of provision for loan losses	98,881	56,504	41,025	196,410

Net revenues	$ 151,151	$ 97,850	$ 43,159	$ 292,160
Facility restructuring and other nonrecurring charges	$ 194,305	$ 18,522	$ 14,422	$ 227,249
Operating income (loss)	$ (222,784)	$ 20,936	$ (16,968)	$ (218,816)
Three Months Ended September 30, 2000:				
Interest income—net of interest expense	$ 68,005	$ 35,372	$ 2,228	$ 105,605
Non-interest revenue—net of provision for loan losses	180,487	14,374	39,796	234,657
Net revenues	$ 248,492	$ 49,746	$ 42,024	$ 340,262
Operating income (loss)	$ 9,946	$ 9,700	$ (10,399)	$ 9,247
Nine Months Ended September 30, 2001:				
Interest income—net of interest expense	$ 163,837	$ 115,951	$ 6,630	$ 286,418
Non-interest revenue—net of provision for loan losses	395,760	132,374	115,368	643,502
Net revenues	$ 559,597	$ 248,325	$121,998	$ 929,920
Facility restructuring and other nonrecurring charges	$ 194,305	$ 18,522	$ 14,422	$ 227,249
Operating income (loss)	$ (235,336)	$ 67,769	$ (40,866)	$ (208,433)
Nine Months Ended September 30, 2000:				
Interest income—net of interest expense	$ 193,527	$ 97,126	$ 5,475	$ 296,128
Non-interest revenue—net of provision for loan losses	645,051	19,940	134,139	799,130
Net revenues	$ 838,578	$ 117,066	$139,614	$ 1,095,258
Operating income (loss)	$ (4,572)	$ 4,591	$ (17,669)	$ (17,650)
As of September 30, 2001:				
Segment assets	$4,438,879	$13,139,802	$450,829	$18,029,510
As of September 30, 2000:				
Segment assets	$7,805,843	$ 9,027,185	$484,409	$17,317,437

No single customer accounted for greater than 10% of total revenues in the three and nine months ended September 30, 2001 or 2000, respectively.

NOTE 17. ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS

Effective October 1, 2000, the Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated anew in hedging relationships on October 1, 2000 or not, are required to be recorded on the

balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income, referred to in this Form 10-Q as OCI and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

Interest Rate Risk

The Company uses derivatives to provide a cost- and capital-efficient way to manage the interest rate risk exposure of the Company by synthetically modifying the repricing or maturity characteristics of certain assets and liabilities and by locking in the rates of certain forecasted issuances of debt. The primary derivative instruments used include interest rate swaps, caps, and floors. The Company enters into interest rate swap agreements to assume fixed-rate interest payments in exchange for variable market-indexed interest payments. Depending on the hedge relationship, the effects of these agreements are to (a) convert adjustable rate liabilities to longer-term fixed rate liabilities, (b) convert long-term fixed rate assets to shorter-term adjustable rate assets or (c) reduce the variability of future changes in interest rates on forecasted issuances of debt. The net payments of these agreements are charged to either interest expense or interest income, depending on whether the agreement is designated to hedge an existing or forecasted liability or asset.

Fair Value Hedges

The Company uses a combination of interest rate swaps, caps and floors to substantially offset the change in value of certain fixed rate assets. In calculating the effective portion of the fair value hedges under SFAS No. 133, the change in the fair value of the hedge agreement is recognized currently in earnings, as is the change in value of the hedged item. Accordingly, the net difference or hedge ineffectiveness, if any, is recognized currently in non-operating income (expense), included in fair value adjustments of financial derivatives. Fair value hedge ineffectiveness resulted in a loss of $2.8 million and $1.0 million for the three and nine months ended September 30, 2001, respectively.

During the three and nine months ended September 30, 2001, multiple fair value hedges were derecognized and therefore hedge accounting was discontinued during the period. Changes in the fair value of these derivative instruments after the discontinuance of fair value hedge accounting are recorded in other revenue in the consolidated statement of operations, which totaled $5.5 million and $10.4 million of losses for the three and nine months ended September 30, 2001, respectively. In addition, the Company recognized $0.3 million of income and $1.1 million of hedge ineffectiveness expense in fair value adjustments of financial derivatives included in non-operating expense for the period in which these hedge relationships were accounted for as fair value hedges during the three and nine months ended September 30, 2001, respectively.

Cash Flow Hedges

Variable Rate Debt and Forecasted Issuances of Debt

The Company also uses interest rate swaps to hedge the variability of future cash flows associated with existing variable rate debt and forecasted issuances of debt. In respect to the variable rate debt currently on the balance sheet, the Company uses interest rate swaps to hedge the risk of changes in the benchmark rate (LIBOR), which impacts the amount of future payments to be made on the variable rate debt. In relation to the hedging of the forecasted issuance of debt, the Company utilizes interest rate swaps with a longer maturity than the underlying variable rate debt. The use of an interest rate swap contract with a longer maturity than the underlying debt allows the Company to hedge both the risk of changes in the benchmark rate (LIBOR) on our existing debt and the replacement of such debt upon maturity. These cash flow hedge relationships will be treated as effective hedges as long as the future issuances of debt remain probable and the hedges continue to meet the requirements of SFAS No. 133. The Company expects to hedge the forecasted issuance of debt over a maximum term of 7 years.

During the three and nine months ended September 30, 2001, the Company reclassified none and $10.9 million, respectively, of derivative losses from OCI to realized gain (loss) on trading activity recorded in other revenue in the consolidated statement of operations for forecasted transactions that had become probable of not occurring.

The Company measures ineffectiveness for these cash flow hedges in accordance with SFAS No. 133. The ineffectiveness for the three and nine months ended September 30, 2001 had no material impact on earnings.

In accordance with the Company’s SFAS No. 133 accounting policy, all interest rate swap agreements in cash flow hedge relationships are recorded at fair value on the balance sheet. OCI is adjusted to the balance that reflects the effective portion of the change in the fair value of the derivative, net of tax. Gains or losses recorded in OCI are recognized in the income statement as the hedged items affect earnings.

Forward Commitments

The Company also uses forward commitments as cash flow hedges of the forecasted purchases or sales of securities. The Company measures ineffectiveness in accordance with the provisions of SFAS No. 133. The ineffectiveness for the three and nine months ended September 30, 2001 had no material impact on earnings. For the three and nine months ended September 30, 2001, there was no material impact in earnings for these forward commitments. The effective portion of the change in fair value of these forward commitments is recorded in OCI, net of tax. The amounts recorded to OCI will be recognized in the statement of operations as the hedged forecasted transactions affect earnings.

Mortgage Banking Activities

The Company enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding, Interest Rate Lock Commitments, referred to in this Form 10-Q as IRLCs. Rate lock commitments on loans that are intended to be sold are considered to be derivatives and are therefore recorded at fair value with changes in fair value recorded in earnings. For purposes of determining their fair value, the Company performs a net present value analysis of the anticipated cash flows associated with the rate lock commitments. Rate lock commitments expose the Company to interest rate risk. The Company manages this risk by selling mortgages or mortgage-backed securities on a forward basis. Changes in the fair value of these derivatives are shown in the statement of operations as gains (losses) on loans held for sale, recorded in other revenue. Changes in the fair value of IRLCs resulted in a gain of $0.2 million and $6.6 million for the three and nine months ended September 30, 2001, respectively. Changes in the fair value of forward sales agreements resulted in gains of $0.9 million and $7.4 million for the three and nine months ended September 30, 2001, respectively.

Loans held for sale expose the company to interest rate risk. The Company manages this risk for certain loans held for sale by selling mortgages or mortgage-backed securities on a forward basis. The changes in fair value of the hedged loans and the related hedging instruments are recorded in the statement of operations as other revenue, which resulted in gains of $4.0 million for the three and nine months ended September 30, 2001.

Foreign Currency Risk

Certain forecasted revenues and expenses are exposed to foreign currency risk. The Company’s objective in hedging anticipated transactions is to mitigate the variability of operating and cash results from fluctuations in currency rates; hedging strategies are not speculative in nature. The Company primarily hedges against fluctuations in the foreign exchange rates of material, anticipated revenues/expenses of TIR which are denominated in non-functional currencies, typically the Japanese yen, the Euro, and the British pound. As the functional currency of TIR is the U.S. dollar and as TIR maintains customer accounts in over thirty currencies, current risk management policies allow authorized persons to enter into forward contracts and purchase options to hedge between 0-100% of exposures deemed material. Material exposures are assessed on the basis of cash flow projections prepared by TIR.

TIR uses forward contracts and purchase options to hedge a portion of forecasted revenue denominated in non-functional currencies for up to one year in the future. Forward contracts and purchase options are designated as cash flow hedging instruments.

In calculating the ineffective portion of the Company’s hedge performance under SFAS No. 133, the Company excludes the time value component related to any option premiums paid and discounts or premiums on forward contracts and recognizes the amount in other income during the life of the contract. These amounts have not been material in the three or nine months ended September 30, 2001. Hedge ineffectiveness related to the Company’s foreign currency hedge instruments, determined in accordance with SFAS No.133, had no impact on earnings for the three or nine months ended September 30, 2001. No foreign exchange cash flow hedges were derecognized or discontinued during the three or nine months ended September 30, 2001.

Derivative gains and losses included in OCI are reclassified into global and institutional revenues at the time forecasted revenue is recognized. During the three and nine months ended September 30, 2001, derivative gains reclassified into revenue were not material. The Company estimates that net derivative gains related to foreign exchange hedges included in other comprehensive loss to be reclassified into earnings within the next twelve months will not be material.

Other Derivatives

The Company owned warrants to purchase shares of common stock of Wit through August 20, 2001. The adjustment to the fair value of these warrants of $(500,000) and $3.7 million is reflected in non-operating income for the three and nine months ended September 30, 2001, respectively. The Company returned these warrants to Wit on August 20, 2001, writing off the net carrying value of $2.5 million that was previously reflected in other assets (see Note 6).

NOTE 18. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued SFAS, No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after December 15, 2001. SFAS No. 141 requires that all business combinations initiated after September 30, 2001 be accounted for under the purchase method of accounting and addresses the initial recognition and measurement of goodwill and intangible assets acquired in the business combination and the accounting for goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that goodwill and intangible assets with indefinite lives not be amortized, but rather be tested at least annually for impairment. The Company will adopt SFAS No. 142 for its fiscal year beginning January 1, 2002. Upon adoption of SFAS No. 142, the Company will stop the amortization of goodwill with an estimated net carrying value of approximately $416.6 million at December 31, 2001 and annual amortization expense of $26.2 million that resulted from business combinations initiated prior to the adoption of SFAS No. 141. Goodwill acquired subsequent to June 30, 2001 is not amortized. Accordingly, the Company will apply the purchase method of accounting to the acquisition of Dempsey and goodwill will not be amortized. The Company will evaluate goodwill under the SFAS No. 142 transitional impairment test and will determine whether or not there is an impairment loss. Any transitional impairment loss will be recognized as a change in accounting principle.

In October 2001, the Financial Accounting Standards Board issued SFAS, No. 144, *Impairment on Disposal of Long-Lived Assets*, effective for fiscal years beginning after December 15, 2001 Under the new rules, the criteria required for classifying an asset as held-for-sale have been significantly changed. Assets held-for-sale are stated at the lower of their fair values or carrying amounts, and depreciation is no longer recognized. In addition, the expected future operating losses from discontinued operations will be displayed in discontinued operations in the period in which the losses are incurred rather than as of the measurement date. More dispositions will qualify for discontinued operations treatment in the income statement under the new rules. The Company is currently evaluating the impact of SFAS No. 144 to its consolidated financial statements.

NOTE 19. SUBSEQUENT EVENTS

On October 1, 2001, the Company acquired Dempsey & Company LLC, referred to in this Form 10-Q as Dempsey, an Illinois limited liability company which is a privately-held specialist and market-making firm, for an aggregate purchase price of approximately $178.5 million, comprised of approximately 28.9 million shares of the Company's common stock valued at $153.4 million, $20.0 million in cash, and direct acquisition costs preliminarily estimated to be $5.0 million. The acquisition will be accounted for using the purchase method of accounting, and the results of Dempsey's operations will be combined with those of the Company from the date of acquisition. The purchase price exceeded the fair value of the tangible assets acquired by approximately $165.0 million, as determined by a preliminary valuation assessment. Of the excess of the purchase price over tangible assets, approximately 40% to 50% will be preliminarily allocated to specialist books representing a revocable license to trade and serve as a specialist for certain securities with the approval of the Chicago Stock Exchange and the remainder has been preliminarily allocated to goodwill. The value allocated to specialist books is expected to be amortized over 30 years on a straight-line basis. Estimates regarding the Company's purchase price allocation are preliminary and are based on the estimated fair value of net tangible and intangible assets acquired, subject to a valuation appraisal which is currently being conducted.

On October 5, 2001, the Bank continued its asset diversification strategy with the acquisition of a $755.0 million pool of consumer loans from Citibank, N.A. and EAB Credit Corporation, a wholly-owned subsidiary of Citibank, N.A. The loans purchased consisted of $221.0 million and $534.0 million in recreational vehicle and auto loans, respectively. The loans will be classified as held for investment on the Company's balance sheet.

On October 15, 2001, the Company, through its wholly-owned subsidiary, the Bank, entered into an agreement to acquire more than 33,000 customer accounts with deposits totaling in excess of $1.5 billion from Chase Manhattan Bank, USA, National Association, a subsidiary of JP Morgan Chase & Co. Final acquisition of these accounts is subject to the Bank's obtaining written approval from the OTS. Through the acquisition of these customer accounts and deposits, the Company expects to further its growth strategy in one of its core businesses.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

*Statements in this document, other than statements of historical information, are forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements, as well as other oral and written forward-looking statements made by us or on our behalf from time to time, including statements contained in our filings with the SEC, and our reports to shareowners, involve known and unknown risks and other factors which may cause our actual results in future periods to differ materially from those expressed in any forward-looking statements. Any such statement is qualified by reference to the risks and factors discussed below under the headings "Liquidity and Capital Resources" and "Risk Factors," as well as in our filings with the SEC, which are available from the SEC or which you may request from us. We caution that the risks and factors discussed below and in such filings are not exclusive. We do not undertake to update any forward-looking statement that may be made from time to time by or on behalf of E*TRADE. You are urged to carefully review and consider the various disclosures in this report and in our other reports filed with the SEC, including our Annual Report on Form 10-K/A as filed with the SEC on November 22, 2000, that attempt to advise you of certain risks and factors that may affect our business. You are cautioned not to place undue reliance on these forward-looking statements to reflect events or circumstances occurring after the date hereof. The following should be read in conjunction with our consolidated financial statements and notes to these consolidated financial statements.*

Results of Operations

Key Performance Indicators

The following tables set forth several key performance indicators which management utilizes in measuring our performance and in explaining the results of our operations for the comparative three and nine months presented and as of September 30, 2001 and 2000 (dollars in thousands except cost per new account, average commission per domestic brokerage transaction and rebate income per domestic brokerage transaction):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2001	2000	Percentage Change	2001	2000	Percentage Change
Net new domestic brokerage accounts	59,822	258,162	(77)%	236,468	1,076,043	(78)%
Net new banking accounts	1,625	65,491	(98)%	73,812	157,438	(53)%
Net new global and institutional accounts	4,640	13,637	(66)%	25,408	48,050	(47)%
Total net new accounts	66,087	337,290	(80)%	335,688	1,281,531	(74)%
Cost per new account	$ 289	$ 211	37%	$ 320	$ 254	26%
Total domestic brokerage transactions(1)	5,138,872	9,112,036	(44)%	20,371,956	33,845,376	(40)%
Daily average domestic brokerage transactions	87,100	144,635	(40)%	110,717	179,076	(38)%
Average commission per domestic brokerage transaction	$ 13.02	$ 14.87	(12)%	$ 13.33	$ 15.36	(13)%
Rebate income per domestic brokerage transaction	$ 1.79	$ 2.11	(15)%	$ 2.21	$ 1.97	12%

	September 30, 2001	September 30, 2000	Percentage Change
Active domestic brokerage accounts	3,348,836	2,951,946	13%
Active banking accounts	436,429	288,073	51%
Active global and institutional accounts	109,432	75,416	45%
Total active accounts at period end	3,894,697	3,315,435	17%
Total customer households at period end	2,902,598	Not Available	
Average assets per household	$ 15,251	Not Available	
Total assets in domestic brokerage accounts	$35,209,944	$59,901,277	(41)%
Total deposits in banking accounts	8,027,993	4,630,068	73%
Total assets in global and institutional accounts	1,032,312	1,348,672	(23)%
Total assets/deposits in customer accounts at period end	$44,270,249	$65,880,017	(33)%

(1) For the three and nine months ended September 30, 2001, four fewer trading days are included as a result of the market closure following the events of September 11, 2001.

For purposes of the tables above:

- A domestic or global brokerage account is included as an active account if the account has a positive asset balance, or if a trade has been made in the account in the past six months or if the account was opened in connection with a corporate employee stock benefit program. Customers may have separate or multiple accounts for each relationship they maintain with us, including separate or multiple brokerage and banking accounts.
- A banking account is included as an active account if a customer has made an initial deposit and the account is not considered abandoned or dormant under applicable Federal and State laws, and the account has not been closed.
- Net new accounts is equal to the number of accounts opened during the applicable period that qualify as active accounts less the number of accounts deactivated due to customer attrition or because the account no longer meets the definition of an active account during the reported period.

• A household is a collection of active accounts, as defined above, which have a matching address and last name.

The following table sets forth the components of both gross and net revenues and percentage change information related to certain items on our Consolidated Statements of Operations for the periods indicated (dollars in thousands):

	Three Months Ended September 30,		Percentage Change	Nine Months Ended September 30,		Percentage Change
	2001	2000		2001	2000	
Transaction revenues:						
Commission	$ 66,917	$132,742	(50)%	$ 271,640	$ 519,986	(48)%
Order flow	9,210	19,234	(52)%	45,113	66,780	(32)%
Total transaction revenues	76,127	151,976	(50)%	316,753	586,766	(46)%
Interest income:						
Brokerage-related activities	71,020	131,937	(46)%	252,483	387,928	(35)%
Banking-related activities	213,926	168,768	27%	648,408	414,750	56%
Total interest income	284,946	300,705	(5)%	900,891	802,678	12%
Global and institutional	37,816	37,185	2%	111,704	127,438	(12)%
Other revenue:						
Gains on sales of originated loans	28,267	—	—%	62,322	—	—%
Gains on sales of Bank loans held for sale	18,281	2,604	602%	26,301	2,928	798%
Other	35,919	44,128	(19)%	129,521	85,464	52%
Total other	82,467	46,732	76%	218,144	88,392	147%
Gross revenues	481,356	536,598	(10)%	1,547,492	1,605,274	(4)%
Interest expense:						
Brokerage-related activities	(16,616)	(61,704)	(73)%	(82,016)	(188,926)	(57)%
Banking-related activities	(172,580)	(133,396)	29%	(532,457)	(317,624)	68%
Total interest expense	(189,196)	(195,100)	(3)%	(614,473)	(506,550)	21%
Provision for loan losses	—	(1,236)	(100)%	(3,099)	(3,466)	(11)%
Net revenues	$292,160	$340,262	(14)%	$ 929,920	$1,095,258	(15)%

Revenues

Gross revenues decreased 10% and 4% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively, and net revenues decreased 14% and 15% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The decreases in net revenues are mainly due to decreases in our brokerage-related activities, including transaction revenues and interest income, which have been affected by the market downturn. The Nasdaq composite index reached a record high in March 2000, compared to a dramatic decline through the period ended September 30, 2001, losing approximately 69% of its value. The sharp decline in the value of publicly traded securities has significantly impacted the total assets in our domestic brokerage accounts, which declined by 41% from September 30, 2000 to September 30, 2001. Gross revenues consist principally of commission revenues from domestic retail brokerage transactions, payments for order flow, interest income, institutional transaction execution fees, international brokerage-related transaction revenue, gains on the sale of loans and securities and, to a lesser degree, revenue from services, brokerage and banking related fees, and advertising revenues.

Transaction Revenues

Transaction revenues decreased 50% and 46% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The decreases are primarily due to the stock market downturn

experienced since a record high achieved in March 2000. Also contributing to the decrease in transaction revenues is the impact of the market being closed for four trading days in September 2001 following the events of September 11, 2001. Transaction revenues consist of commission revenues from domestic retail brokerage transactions and payments for order flow.

Commission revenues, which are earned as customers execute domestic securities transactions, decreased 50% and 48% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. These revenues are primarily affected by total domestic brokerage transactions, which decreased 44% and 40% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. These decreases are largely reflective of the market downturn, which has continued through September 30, 2001 as unfavorable economic news continues to impact investor trading.

Revenue from order flow is comprised of rebate income from various market-makers and market centers for processing transactions through them. We use other broker-dealers to execute our customers' orders and have derived a significant portion of our transaction revenues from these broker-dealers for such order flow. This practice of receiving payment for order flow is widespread in the securities industry. Under applicable SEC regulations, receipt of these payments requires disclosure of such payments by us to our customers. Revenues from order flow decreased 52% and 32% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. This decrease primarily reflects the 44% and 40% decrease in domestic brokerage transactions processed in the three and nine months ended September 30, 2001, respectively, as compared to the prior year periods. Further, impacting revenues from order flow, the listed marketplace implemented the move from fractional based trading to decimals based trading, commonly referred to as decimalization, in January 2001, and the NASDAQ initiated decimalization in March 2001. The implementation of decimalization, which reduced market-maker and market center spreads, has decreased the order flow revenue associated with equity transactions. With the acquisition of Dempsey, we expect our revenue from order flow to continue to decrease to the extent we direct order flow to Dempsey. Offsetting the decrease in order flow revenues related to the acquisition of Dempsey, net revenues will include the revenues of Dempsey from the date of acquisition. This decrease in order flow revenue associated with equity transactions has been partially offset by the receipt of option order flow beginning in October 2000. We cannot be certain that rebates per transaction will continue at the same levels in future periods.

With the relatively recent implementation of decimalization, certain market-makers have reduced payments for order flow, others have announced plans to reduce payments for order flow, and others continue to take a "wait and see" approach. Going forward, we expect revenue from order flow to continue to decrease due to decimalization, however, at this time, we are unable to quantify the future impact on net revenues. Further, there can be no assurance that we will be able to continue our present relationships and terms for such payments for order flow. In addition, there can be no assurance that payments for order flow will continue to be permitted by the SEC, the NASDR or other regulatory agencies, courts or governmental units. Loss of any or all of these revenues could harm our business. See "Item 2. Risk Factors—Restrictions on the ability of, or decreased willingness of, third parties to make payments for order flow or potential payments by us to third parties for handling orders could reduce our profitability."

Overall, transaction revenues as a percentage of net revenues have decreased from 45% and 54% in the three and nine months ended September 30, 2000, respectively, to 26% and 34% in the three and nine months ended September 30, 2001, respectively, due to our efforts to diversify revenue streams and also due, in part, to the market downturn. Although we continue to diversify our revenue sources, we expect transaction revenues to account for a significant portion of our revenues in the foreseeable future. A protracted economic downturn could significantly harm our business. See "Item 2. Risk Factors—As a significant portion of our revenues come from online investing services, downturns in the securities industry have harmed and could further significantly harm our business, including by reducing transaction volumes and margin borrowing and increasing our dependence on our more active customers who receive lower prices.

Interest Income and Expense

Interest income from brokerage-related activities is comprised of interest earned by our brokerage subsidiaries on credit extended to customers to finance their purchases of securities on margin and fees on customer assets invested in money market accounts. Interest expense from brokerage-related activities is comprised of interest paid to customers on certain credit balances, interest paid to banks and interest paid to other broker-dealers through our brokerage subsidiary's stock loan program. Interest income from banking-related activities reflects interest earned on assets, consisting primarily of loans receivable and mortgage-backed securities. Interest expense from banking-related activities is comprised of interest-bearing banking liabilities that include customer deposits, advances from the FHLB, and other borrowings.

Brokerage interest income decreased 46% and 35% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The decrease in brokerage interest income primarily reflects the decrease in average customer margin balances, which decreased by 59% and 54% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The dramatic decline in the equity markets since March 2000 reduced borrowing on margin by customers as a means of leveraging their investments. Partially offsetting this decrease are increases in the average stock borrow balances in the nine months ended September 30, 2001 from the comparable period in 2000, and increases in average customer money market fund balances in the three and nine months ended September 30, 2001 from the comparable periods in 2000. Average stock borrow balances increased 90% in the nine months ended September 30, 2001 from the comparable period in 2000, which increased stock borrow interest from $31.5 million to $45.9 million in the nine months ended September 30, 2001 from the comparable period in 2000. Average stock borrow balances decreased 1% in the three months ended September 30, 2001 from the comparable period in 2000, which together with a decline in stock borrow interest rates decreased stock borrow interest from $15.3 million in the three months ended September 30, 2000 to $9.7 million in the three months ended September 30, 2001. Average customer money market fund balances increased 6% and 17% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively, which has increased fees earned on customer assets invested in money market funds.

Brokerage interest expense decreased 73% and 57% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The decrease in brokerage interest expense primarily reflects a decrease in average stock loan balances and average customer credit balances, and a decline in stock loan interest rates and customers credit interest rates. Average stock loan balances decreased 57% and 45% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively, resulting in a decline in stock loan interest expense of $40.7 million and $99.4 million from the three and nine months ended September 30, 2000 to the comparable periods in 2001, respectively. Average customer credit balances decreased 14% and 11% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. Net brokerage interest income decreased 23% and 14% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively, primarily due to the effects of the market downturn. This decrease harms our net revenues and operating income.

The following table sets forth the increases and decreases in average customer margin balances, average customer money market fund balances, average stock borrow balances, average stock loan balances, and average customer credit balances for the three and nine months indicated (dollars in millions):

	Three Months Ended September 30,	Percentage	Nine Months Ended September 30,	Percentage

	2001	2000	Change	2001	2000	Change
Average customer margin balances	$1,900	$4,660	(59)%	$2,256	$4,879	(54)%
Average customer money market fund balances	$8,421	$7,912	6%	$8,550	$7,331	17%
Average stock borrow balances	$1,150	$1,158	(1)%	$1,542	$ 810	90%
Average stock loan balances	$1,599	$3,695	(57)%	$2,168	$3,960	(45)%
Average customer credit balances	$1,092	$1,277	(14)%	$1,150	$1,298	(11)%

Banking interest income increased 27% and 56% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. Increases in banking interest income reflect overall growth in our banking segment including increases in the average interest-earning banking asset balances, partially offset by a decline in the average yield. Average interest-earning banking assets increased 45% and 71% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The average yield on interest-earning banking assets decreased to 6.88% and 7.15% in the three and nine months ended September 30, 2001 from 7.87% and 7.83% in the three and nine months ended September 30, 2000, respectively.

Banking interest expense increased 29% and 68% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The increase in banking interest expense reflects an increase in the average interest-bearing banking liability balances partially offset by a decrease in the average cost of the borrowings. Average interest-bearing banking liability balances increased 46% and 72% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The average cost of borrowings decreased to 5.83% and 6.22% in the three and nine months ended September 30, 2001, respectively, from 6.57% and 6.36% in the three and nine months ended September 30, 2000, respectively. The decrease in the average net interest spread from 1.30% and 1.47% in the three and nine months ended September 30, 2000, respectively, to 1.05% and 0.93% in the three and nine months ended September 30, 2001, respectively, is primarily a result of the increased leverage of the Bank partially offset by a decrease in the costs of retail deposits. Average retail deposits in banking accounts increased 85% and 97% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively.

The following table presents average balance data and income and expense data for our banking operations and the related interest yields and rates for the three and nine months ended September 30, 2001 and 2000. The table also presents information with respect to net interest margin, an indicator of profitability. Another indicator of profitability is net interest spread, which is the difference between the weighted average yield earned on interest-earning banking assets and the weighted average rate paid on interest-bearing banking liabilities (dollars in thousands):

	Three Months Ended September 30, 2001			Three Months Ended September 30, 2000		
	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost
Interest-earning banking assets:						
Loans receivable, net	$ 6,670,748	$121,376	7.28%	$4,171,660	$ 84,543	8.25%
Interest-bearing deposits	257,257	1,751	2.70%	42,340	699	6.57%
Mortgage-backed and related available-for-sale securities	4,066,334	67,570	6.65%	3,922,858	75,082	7.66%
Available-for-sale investment securities	1,316,166	21,963	6.71%	305,885	5,733	7.64%
Investment in FHLB stock	57,503	868	5.98%	89,342	1,737	7.74%
Trading securities	75,347	398	2.11%	50,793	974	7.67%
Total interest-earning banking assets	12,443,355	$213,926	6.88%	8,582,878	$168,768	7.87%
Non-interest-earning banking assets	578,519			133,144		
Total banking assets	$13,021,874			$8,716,022		
Interest-bearing banking liabilities:						
Retail deposits	$ 7,786,062	$110,007	5.65%	$4,207,274	$ 67,646	6.43%
Brokered callable certificates of deposit	—	—	-%	91,726	1,559	6.74%
FHLB advances	1,007,648	16,119	6.26%	1,752,788	29,258	6.53%
Other borrowings	2,953,331	46,454	6.15%	2,020,919	34,933	6.76%
Total interest-bearing banking liabilities	$11,747,041	$172,580	5.83%	8,072,707	$133,396	6.57%
Non-interest bearing banking liabilities	511,087			114,958		
Total banking liabilities	12,258,128			8,187,665		

Total banking shareowner's equity	763,746			528,357		
Total banking liabilities and shareowner's equity	$13,021,874			$8,716,022		
Excess of interest-earning banking assets over interest-bearing banking liabilities/net interest income	$ 696,314	$ 41,346		$ 510,171	$ 35,372	
Net interest spread			1.05%			1.30%
Net interest margin (net yield on interest-earning banking assets)			1.33%			1.65%
Ratio of interest-earning banking assets to interest-bearing banking liabilities			105.93%			106.32%
Return on average total banking assets			0.52%			0.22%
Return on average net banking assets			8.84%			3.60%
Equity to total banking assets			5.63%			7.40%

• Ratios calculated by excluding our Employee Stock Ownership Plan, merger related and restructuring costs of $10.2 million (net of tax expense of $8.3 million) and $0.3 million (net of tax expense of $0.1 million) in the three months ended September 30, 2001 and 2000, respectively.

	Nine Months Ended September 30, 2001			Nine Months Ended September 30, 2000		
	Average Balance	**Interest Income/ Expense**	**Average Annualized Yield/Cost**	**Average Balance**	**Interest Income/ Expense**	**Average Annualized Yield/Cost**
Interest-earning banking assets:						
Loans receivable, net	$ 6,400,360	$360,692	7.51%	$3,444,017	$209,283	8.10%
Interest-bearing deposits	120,068	3,133	3.49%	64,250	2,885	5.98%
Mortgage-backed and related available-for-sale securities	4,247,114	216,440	6.79%	3,219,272	184,080	7.62%
Available-for-sale investment securities	1,168,265	61,504	7.06%	241,440	12,962	7.34%
Investment in FHLB stock	68,584	3,407	6.64%	70,796	4,107	7.73%
Trading securities	91,195	3,232	4.73%	27,011	1,433	7.07%
Total interest-earning banking assets	12,095,586	$648,408	7.15%	7,066,786	$414,750	7.83%
Non-interest-earning banking assets	456,829			219,498		
Total banking assets	$12,552,415			$7,286,284		
Interest-bearing banking liabilities:						
Retail deposits	$ 6,974,785	$317,515	6.09%	$3,539,925	$164,368	6.19%
Brokered callable certificates of deposit	39,088	1,810	6.19%	91,764	4,520	6.56%
FHLB advances	1,302,415	64,052	6.49%	1,389,166	67,269	6.36%
Other borrowings	3,123,946	149,080	6.29%	1,632,853	81,467	6.56%
Total interest-bearing banking liabilities	11,440,234	$532,457	6.22%	6,653,708	$317,624	6.36%
Non-interest bearing banking liabilities	399,274			129,953		
Total banking liabilities	11,839,508			6,783,661		
Total banking shareowner's equity	712,907			502,623		
Total banking liabilities and shareowner's equity	$12,552,415			$7,286,284		

Excess of interest-earning banking assets over interest-bearing banking liabilities/net interest income	$ 655,352	$115,951		$ 413,078	$ 97,126	
Net interest spread			0.93%			1.47%
Net interest margin (net yield on interest-earning banking assets)			1.28%			1.84%
Ratio of interest-earning banking assets to interest-bearing banking liabilities			105.73%			106.21%
Return on average total banking assets			0.43%			(0.08)%
Return on average net banking assets			7.65%			(1.13)%
Equity to total banking assets			5.63%			7.40%

- Ratios calculated by excluding Employee Stock Ownership Plan, merger related and restructuring costs of $10.2 million (net of tax expense of $8.3 million) and $1.3 million (net of tax expense of $0.3 million) in the nine months ended September 30, 2001 and 2000, respectively.

Global and Institutional

Global and institutional revenues increased 2% and decreased 12% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The slight increase in global and institutional revenues for the three month comparative period reflects the increase in active global and institutional accounts from 75,000 at September 30, 2000 to 109,000 at September 30, 2001. The decrease in global and institutional revenues from the nine month comparative period is primarily attributable to a slowdown in the institutional business due to global market conditions in the nine months ended September 30, 2001.

Other Revenue

Other revenues increased 76% and 147% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively, primarily resulting from purchase acquisitions since May 2000 and gains on the sales of Bank loans held for sale, with the remaining portion of other revenues comprised of brokerage and banking-related fees for services, Business Solutions Group revenue, and mutual fund revenues.

Gains on the sales of originated loans reflect the revenues contributed by E*TRADE Mortgage. Revenues generated from E*TRADE Mortgage have been combined with our revenues since February 1, 2001, the date of acquisition. Also included in other revenue are gains on sales of Bank loans held for sale.

Other decreased 19% and increased 52% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. The decrease for the three month period is primarily due to a decrease in net gains from trading and available for sale securities and a decrease in revenues generated from advertising and mutual funds. The increase in the nine month period primarily reflects nine months of activity generated by the purchase acquisition of E*TRADE Access, Inc., since its acquisition in May 2000 and the implementation of a quarterly account maintenance fee for low-balance, inactive accounts in December 2000. For purposes of the quarterly maintenance fee, an inactive account is one in which there have been less than two commission generating transactions in the six months prior to quarter end.

In future periods, gains on sales of Bank loans held for sale may fluctuate. We expect to continue our policy of assessing maintenance fees for low-balance, inactive accounts. Revenues from our purchase acquisitions will fluctuate and may decrease.

Loans Receivable and Provision for Loan Losses

The provision for loan losses recorded reflects adjustments in our allowance for loan losses based upon management's review and assessment of the risk in our loan portfolio. The provision for loan losses was none and $3.1 million in the three and nine months ended September 30, 2001, respectively, and $1.2 million and $3.5 million in the three and nine months ended September 30, 2000, respectively. The Company did not record a provision for loan losses during the three months ended September 30, 2001 because the aggregate risk in the loan portfolio decreased at September 30, 2001 as compared to June 30, 2001. The reduction in risk in the loan portfolio primarily resulted from an approximate 9% decrease in total loans from June 30, 2001 to September 30, 2001. The net reduction in total loans was principally attributable to the sale of a $946.6 million pool of loans in August 2001. As of September 30, 2001 and 2000, the total loan loss allowance was $13.9 million, or 0.22% of total loans outstanding, and $10.9 million, or 0.26% of total loans outstanding, respectively. As summarized below, as of September 30, 2001, the loan loss allowance was $13.9 million, or 83.39% of total non-performing loans of $16.7 million. As of September 30, 2000, the loan loss allowance was $10.9 million, or 90.72% of total non-performing loans of $12.0 million.

The following table presents information concerning our banking loan portfolio as of September 30, 2001 and 2000, in dollar amounts, by type of loan. Subsequent to September 30, 2000 and consistent with our loan diversification strategy, we began purchasing loans secured by automobiles, leading to the significant increase in the percentage of loans backed by autos shown as of September 30, 2001 (dollars in thousands):

	September 30, 2001	Percentage	September 30, 2000	Percentage

Real estate loans:				
One- to four-family	$4,635,256	73.4%	$4,123,684	97.6%
Multi-family	—	0.0%	203	0.0%
Commercial	1,995	0.0%	2,717	0.1%
Mixed-use	630	0.0%	503	0.0%
Consumer and other loans:				
Autos	1,056,903	16.7%	—	—
Home equity lines of credit and second mortgage loans	10,341	0.2%	4,042	0.1%
Lease financing	—	0.0%	82	0.0%
Other	13,499	0.2%	224	0.0%
Loans held for sale	596,945	9.5%	95,400	2.2%
Total loans	6,315,569	100.00%	4,226,855	100.0%
Unamortized premiums (discounts), net	250		(43,171)	
Less allowance for doubtful accounts	(13,939)		(10,930)	
Total	$6,301,880		$4,172,754	

The following table presents information about our non-accrual loans and repossessed assets as of the periods indicated. The Company had no troubled debt restructurings, commonly referred to as TDRs, as of September 30, 2001 and 2000 (dollars in thousands):

	September 30, 2001	September 30, 2000
Loans accounted for on a non-accrual basis:		
Real estate loans:		
One- to four-family	$16,642	$11,391
Commercial	—	657
Total real estate loans	16,642	12,048
Autos	74	—
Total non-performing loans	16,716	12,048
Repossessed assets	1,679	850
Total non-performing assets	$18,395	$12,898
Total non-performing assets as a percentage of total loans	0.29%	0.31%
Total non-performing assets as a percentage of total banking assets	0.14%	0.14%
Total loan loss allowance as a percentage of total non-performing loans	83.39%	90.72%
Total non-performing loans as a percentage of total loans	0.26%	0.29%

Activity in the allowance for loan losses is summarized as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Allowance for loan losses, beginning of the period	$15,080	$ 9,722	$12,565	$ 7,647
Provision for loan losses	—	1,236	3,099	3,466
Charge-offs, net	(1,141)	(28)	(1,725)	(183)

Allowance for loan losses, end of period	$13,939	$10,930	$13,939	$10,930

Cost of Services and Operating Expenses

The following table sets forth the components of cost of services and operating expenses and percentage change information for the three and nine months ended September 30, 2001 and 2000 (dollars in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2001	2000	Percentage Change	2001	2000	Percentage Change
Cost of services	$140,519	$136,156	3%	$433,412	$400,317	8%
Cost of services as a percentage of net revenues	48%	40%		47%	37%	
Operating expenses:						
Selling and marketing	$ 50,268	$ 91,774	(45)%	$199,365	$389,703	(49)%
Technology development	20,882	28,490	(27)%	66,583	105,617	(37)%
General and administrative	55,250	61,292	(10)%	177,398	166,031	7%
Amortization of goodwill and other intangibles	11,421	8,395	36%	28,442	20,600	38%
Acquisition-related expenses	5,387	4,908	10%	5,904	30,640	(81)%
Facility restructuring and other nonrecurring charges	227,249	—	—	227,249	—	—
Total operating expenses	$370,457	$194,859	90%	$704,941	$712,591	(1)%

Cost of Services

Cost of services increased 3% and 8% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. This increase is the result of the addition of expenses for E*TRADE Access and E*TRADE Mortgage, as well as the impact in 2001 of amortization of internally developed software as a significant number of large projects were completed in November 2000. Also impacting cost of services is increased activity in our banking and global and institutional business segments, where active customer accounts have increased 51% and 45%, respectively, from September 30, 2000 to September 30, 2001. Growth in our banking and international subsidiaries combined with investment in our asset gathering business resulted in approximately $18.6 million and $58.1 million in the three and nine months ended September 30, 2001, respectively, of additional costs incurred. These additions to costs have been partially offset by reduced clearing and other transaction-related expenses as volumes have decreased year over year, and by the operating improvements described below. The initial impact of our facility restructuring, effective August 29, 2001, has also been reflected in the three months ended September 30, 2001.

Cost of services has not decreased at the same level as transaction revenues because of the need to maintain an acceptable level of customer service across an account base that continues to grow and the need to service a wider range of product offerings. Further impacting cost of services as a percentage of net revenues, which increased to 48% and 47% in the three and nine months ended September 30, 2001, respectively, from 40% and

37% in the three and nine months ended September 30, 2000, respectively, is the decrease in net revenues from the prior year comparable periods. Looking forward, we plan to continue to identify and implement cost savings strategies in this area, including the full integration of our bank and brokerage customer service and the implementation of a tiered customer service strategy across the organization which will include improved interactive voice response call servicing and a tier-focused automated call routing system. Additionally, we expect to recognize further benefit from our facility restructuring.

Selling and Marketing

Selling and marketing expenses decreased 45% and 49% in the three and nine months ended September 30, 2001 from the comparable prior year periods, respectively. The selling and marketing expenditures reflect expenditures for advertising placements, creative development and collateral materials resulting from a variety of advertising campaigns directed at expanding brand identity, growing the customer base and increasing market share. Selling and marketing expenditures also include selling efforts in support of our global and institutional business segment. The decreases in selling and marketing expenses are primarily due to reductions in customer acquisition spending, including advertising, online and direct mailing and promotional activities, which are expected to remain at lower than prior year levels. Although our marketing dollars are being spent more efficiently since we cross sell banking services to our brokerage customers in accordance with applicable regulatory requirements, cost per new account increased from $211 in the three months ended September 30, 2000 to $289 in the three months ended September 30, 2001. The increase in cost per new account reflects a decline in the growth in net new accounts in the three and nine months ended September 30, 2001 of 80% and 74%, respectively, as compared to the same periods in 2000. The decline in net new account growth is due to the fact that it is more difficult to acquire new accounts under current market conditions. Going forward, our focus will be on developing current customer households, reviewing metrics such as value per household, assets per household and “share of wallet”, or a percentage of a household’s total assets held in our customer accounts, instead of cost per new account. As of September 30, 2001, customer households totaled 2.9 million, and average assets totaled $15,251. We expect that marketing expenditure levels will be significantly lower during calendar year 2001 as compared with the prior year. If general market conditions improve, we will examine whether to increase our spending. We believe that our reduction in selling and marketing expenditures should not significantly impact our competitive position because substantial investment in marketing efforts has already been made to build a strong brand identity and because we are focusing marketing and sales resources on cross selling our services to our existing customer base, which is a less expensive way to generate and maintain business.

Technology Development

Technology development expenses decreased 27% and 37% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively, due to focused investment on core projects. Management reviewed our current technology development activities and has chosen to focus on projects generating the highest payback in the short term. As such, work on less critical projects ceased during the three months ended September 30, 2001. We have invested, and continue to invest, in the development of technology to enhance our existing product offerings, including enhancements to our website and brokerage systems, and development of Customer Relationship Management, commonly referred to as CRM, capabilities. Development efforts during the first nine months of 2001 have resulted in product offerings, which support active traders and our CRM systems. Once these projects were completed, the use of outside contractors was reduced. During the nine months ended September 30, 2001, significant phases of our CRM project and active trader products were implemented, and amortization of these costs began. With management's continuing focus on cost efficiencies, no significant increases in technology development spending are planned. Management believes that the level of current technology development spending is appropriate to support pending initiatives and to operate competitively.

General and Administrative

General and administrative expenses decreased 10% and increased 7% in the three and nine months ended September 30, 2001 from the comparable periods in 2000, respectively. For the three month period, general and administrative expenses decreased primarily as a result of reduced spending on corporate overhead expense and an increased focus on spending controls. In addition, the initial impact of our facility restructuring and other nonrecurring charges, effective August 29, 2001, has also been reflected in the three months ended September 30, 2001. For the nine month period, general and administrative expenses have increased primarily as a result of increased costs related to the growth of our banking segment, which includes the operations of E*TRADE Access and E*TRADE Mortgage. In addition, we incurred a $9.8 million compensation charge in January 2001. Of this amount, approximately $9.6 million is nonrecurring and is related to the vesting of funds contributed to our SERP. Looking forward, we expect that general and administrative expenses will remain at least flat with the three months ended September 30, 2001, allowing for increases as we include the operations of Dempsey, effective October 2, 2001, offset by possible reductions as we continue to integrate our business acquisitions, continue our ongoing efforts to re-engineer and reorganize our business to realize operating efficiencies, and review expenses in response to current and future market, business and economic conditions. We will continue to actively balance headcount needs through responsible hiring, attrition, efficient use of our associates and performance leadership based management as part of our guiding principles.

Facility Restructuring and Other Nonrecurring Charges

On August 29, 2001, we announced a restructuring plan aimed at streamlining operations and enhancing profitability primarily by consolidating facilities in the United States and Europe. This restructuring resulted in a pre-tax charge of $227.2 million ($125.2 million after tax) for the three months ended September 30, 2001. We expect to realize a recurring annual pretax benefit of approximately $60-$70 million. We expect the move will enable us to manage our global business more efficiently and reduce our fixed cost structure while maintaining our ability to deliver customer value.

Over the past three years, we have completed more than 16 acquisitions of companies with facilities in major metropolitan centers in the United States and Europe. We are consolidating some of these facilities to bring together key decision-makers and streamline operations. As part of this initiative, we are vacating our facilities in Portland, Oregon and San Francisco, California and relocating associates to our facilities in Menlo Park and Rancho Cordova, California and Arlington, Virginia, as well as the soon-to-be-opened E*TRADE Center in San Francisco, California. Also, we are combining operations in several international countries and consolidating international back office operations. We have recorded a pre-tax restructuring charge of $133.0 million related to our facilities consolidation, representing the undiscounted value of ongoing lease commitments offset by anticipated third party subleases. The charge also includes a pre-tax write-off of leasehold improvements totaling $37.0 million and anticipated operating costs committed in new, third party sublease property agreements of $42.6 million. The charge does not include relocation costs that will be incurred over the next 12 months and expensed as incurred. The cash outflow related to this action will be paid out over the length of our committed lease terms of 7 to 10 years.

As a result of our worldwide consolidation activities, certain software developed for specific locations and certain other fixed assets will no longer be used. In addition, management reviewed our current technology development activities and has chosen to focus on projects generating the highest return in the short term; as such, work on less critical projects has ceased. In total, we are taking a pre-tax charge of $49.9 million related to writing off capitalized software and hardware related to the aforementioned technology projects and for other fixed assets.

The restructuring accrual also includes other pre-tax charges of $44.3 million for committed expenses, renegotiation and waiver of certain employment related contractual obligations, termination of consulting agreements and cancellation penalties on various services that will no longer be required in the facilities we are vacating.

A summary of the facility restructuring and other nonrecurring charges is outlined as follows (in thousands):

	Facility Consolidation	Asset Write-Off	Other	Total
Facility restructuring and other nonrecurring charges	$132,999	$49,947	$44,303	$227,249
Activity through September 30, 2001:				
Cash charges	(77)	—	(1,311)	(1,388)
Noncash charges	(43,173)	(45,681)	(18,639)	(107,493)
Restructuring liabilities at September 30, 2001	$ 89,749	$ 4,266	$24,353	$118,368

Amortization of Goodwill and Other Intangibles

Amortization of goodwill and other intangibles was $11.4 million and $28.4 million in the three and nine months ended September 30, 2001, respectively, and $8.4 million and $20.6 million in the three and nine months ended September 30, 2000, respectively. The significant increase in the amortization of goodwill and other intangibles primarily consists of the amortization of goodwill and other intangibles related to the purchase acquisition of E*TRADE Access in May 2000, the purchase acquisition of E*TRADE Germany, which was acquired during the three months ended December 31, 2000, and the purchase acquisition of E*TRADE Mortgage, which was acquired in February 2001. Goodwill is amortized over 5 to 20 years. Upon our adoption of SFAS No. 142, *Goodwill and Other Intangible Assets*, on January 1, 2002, we will discontinue the amortization of goodwill subject to the new pronouncements. See "Recent Accounting Pronouncements." We acquired Web Street in the three months ended June 30, 2001 and have preliminarily allocated the excess of the purchase price over the fair value of net tangible assets to active accounts acquired. We will amortize approximately $37.2 million in related capitalized costs over seven years using an accelerated method.

Acquisition-Related Expenses

Acquisition-related expenses were $5.4 million and $5.9 million in the three and nine months ended September 30, 2001, respectively, and $4.9 million and $30.6 million in the three and nine months ended September 30, 2000, respectively, and primarily represent transaction costs associated with various acquisitions accounted for as poolings of interests prior to June 30, 2001. Also included in acquisition-related expenses in the three and nine months ended September 30, 2001, was approximately $5.4 million related to losses incurred by Web Street during the transition of Web Street's accounts to our systems. This transition is expected to be completed in the fourth quarter of 2001, at which time all of Web Street's domestic stand-alone operations will cease.

Non-Operating Income (Expense)

Corporate interest income was $6.8 million and $17.8 million in the three and nine months ended September 30, 2001, respectively, and $5.8 million and $15.0 million in the three and nine months ended September 30, 2000, respectively. Corporate interest income includes interest income earned on corporate investment balances, restricted cash balances, and related party notes. The increase in corporate interest income was primarily due to the increase in our corporate investments from $293.7 million as of September 30, 2000 to $597.7 million as of September 30, 2001, reflecting the issuance of $325 million ($315.3 million, net of issuance costs) of 6.75% convertible subordinated notes in May 2001 and interest income earned on related party notes, which were entered into during the period from March 2000 through June 2001.

Corporate interest expense was $15.3 million and $39.3 million in the three and nine months ended September 30, 2001, respectively, and $11.4 million and $29.5 million in the three and nine months ended September 30, 2000, respectively. Corporate interest expense in the three months ended September 30, 2001 and 2000 primarily relates to interest expense resulting from the issuance of $650 million in convertible subordinated

notes in February and March 2000 and the issuance of $325 million in convertible subordinated notes in May 2001, net of the extinguishment of $115 million of our 6% convertible subordinated notes.

Realized loss on investments was $32.5 million and $48.0 million in the three and nine months ended September 30, 2001, respectively, and realized gain on investments was $144.5 million and $179.8 million in the three and nine months ended September 30, 2000, respectively. For the three months ended September 30, 2001, losses on investments included an aggregate pre-tax $33.0 million impairment write down of equity method and other investments, including a $19.5 million loss following our disposition of our holdings in Wit (discussed in Note 6 to Condensed Consolidated Financial Statements, above) partially offset by immaterial net realized gains on the sale our proprietary mutual fund investments and the sale of a publicly traded equity security. For the nine months ended September 30, 2001, loss on investment included a $46.1 million impairment write down on publicly traded equity securities, proprietary mutual funds, and equity method and other investments, and an immaterial loss on the sale of an equity method investment. In the three and nine months ended September 30, 2000, realized gain on investments was recorded as a result of the sales of publicly traded equity securities.

Equity in losses of investments was $1.1 million and $6.2 million in the three and nine months ended September 30, 2001, respectively, and $5.5 million and $7.6 million in the three and nine months ended September 30, 2000, respectively. Losses reflected our investment in Wit, accounted for under the equity method through August 20, 2001, and our equity investment in eAdvisor. Equity in losses of investments was partially offset by income recorded from our equity investments in E*TRADE Japan KK and AG Arbor, Inc.

In the three and nine months ended September 30, 2001 and 2000, we recorded unrealized losses on venture funds of $13.5 million and $34.1 million and $8.1 million and $26.2 million, respectively, primarily due to our participation in Softbank Capital Partners, L.P., E*TRADE eCommerce Fund, L.P. and E*TRADE eCommerce Fund II, L.P. These changes represent market fluctuations on public investments held by the funds and changes in the estimated value of their non-public investments.

In the three and nine months ended September 30, 2001, we recorded a loss of $3.3 million and $4.7 million, respectively, for the fair value adjustments of financial derivatives. In the three months ended September 30, 2001, the amount represents a $0.5 million loss on the valuation of warrants and a $2.8 million loss for the ineffective portions of changes in the fair value of fair value hedges. In the nine months ended September 30, 2001, the amount represents a $3.7 million loss on the valuation of warrants and a $1.0 million loss representing the ineffective portions of changes in the fair value of fair value hedges. The Company owned warrants to purchase shares of common stock of Wit through August 20, 2001. The adjustment to the fair value of these warrants is reflected in non-operating income for the three and nine months ended September 30, 2001, respectively. The Company returned these warrants to Wit on August 20, 2001, writing off the net carrying value of $2.5 million reflected in other assets.

Other non-operating expense was $0.4 million and $0.8 million in the three and nine months ended September 30, 2001, respectively, and $0.3 million and $2.0 million in the three and nine months ended September 30, 2000, respectively. Other non-operating expense, which is primarily comprised of foreign exchange gains (losses), was recorded primarily as a result of fluctuations in foreign exchange rates for assets and liabilities held on our balance sheet that are denominated in non-functional currencies.

Income Tax Expense (Benefit)

Income tax expense (benefit) represents a benefit for federal and state income taxes at an effective tax rate of (7)% and (14)% for the three and nine months ended September 30, 2001, respectively, and an expense of 65% and 77% for the three and nine months ended September 30, 2000, respectively. The rate for the three and

nine months ended September 30, 2001 reflects an increase in the tax benefit due to federal and state research and development income tax credits, a decrease in the tax benefit for the amortization of goodwill, facility restructuring and other nonrecurring charges and differences between our statutory and foreign effective tax rates. The rate for the three and nine months ended September 30, 2000 reflects the tax impact of non-deductible acquisition-related expenses and amortization of goodwill arising from foreign acquisitions.

Minority Interest in Subsidiaries

Minority interest in subsidiaries was $0.3 million and none in the three and nine months ended September 30, 2001, respectively, and $0.5 million and $0.7 million in the three and nine months ended September 30, 2000, respectively. Minority interest in subsidiaries results primarily from ETFC's interest payments to subsidiary trusts which have issued Company-obligated manditorily redeemable capital securities and which hold junior subordinated debentures of ETFC. Also included in minority interest in subsidiaries for the three and nine months ended September 30, 2001 and 2000 is the net loss attributed to a minority interest in one of our international affiliates.

Extraordinary Gain on Early Extinguishment of Debt

We recorded an extraordinary gain on early extinguishment of debt of $15.2 million (net of tax expense of $10.2 million) and $15.3 million (net of tax expense of $10.8 million) in the three and nine months ended September 30, 2001, respectively. In the three months ended September 30, 2001, amounts recorded included a $16.9 million gain (net of tax expense of $11.3 million) on exchanges in the aggregate of $60.0 million of our 6% convertible subordinated notes for approximately 6.4 million shares of our common stock and repurchases in the aggregate of $25.0 million of our 6% convertible subordinated notes for approximately $15.3 million paid in cash, offset by a $1.7 million loss (net of tax benefit of $1.1 million) recorded as a result of the early redemption of $227.0 million of adjustable and fixed rate advances from the FHLB. In the nine months ended September 30, 2001, amounts recorded included a $22.0 million gain (net of tax expense of $14.7 million) on exchanges in the aggregate of $90.0 million of our 6% convertible subordinated notes for approximately 9.2 million shares of our common stock and repurchases in the aggregate of $25.0 million of our 6% convertible subordinated notes for approximately $15.3 million paid in cash, offset by a $6.7 million loss (net of tax benefit of $4.5 million) recorded as a result of the early redemption of $827.0 million of adjustable and fixed rate advances from the FHLB. The FHLB advances were entered into as a result of normal funding requirements of our banking operations. The loss consisted primarily of prepayment penalties and costs associated with these early redemptions.

Liquidity and Capital Resources

We have financing facilities totaling $275.0 million to meet the needs of E*TRADE Securities. These facilities, if used, would be collateralized by customer securities or restricted cash included in other assets. There were no borrowings outstanding under these lines as of September 30, 2001. In addition, we have a short-term line of credit for up to $50.0 million, collateralized by marketable securities owned by us, of which there were no outstanding borrowings as of September 30, 2001. We also have three term loans collateralized by equipment owned by us, of which $14.7 million was outstanding as of September 30, 2001. We have also entered into numerous agreements with other broker-dealers to provide financing under our stock loan program.

On May 29, 2001, the Company completed a private offering of $325 million convertible subordinated notes due May 2008. The notes are convertible, at the option of the holder, into a total of approximately 29.7 million shares of the Company's common stock at a conversion price of $10.925 per share. The notes bear interest at 6.75%, payable semiannually, and are non-callable for three years and may then be called by the Company at a premium, which declines over time. The holders have the right to require redemption at a premium in the event of a change in control or other defined redemption event. The Company expects to use the net proceeds for general corporate purposes, including capital expenditures and to meet working capital needs. Debt issuance costs of $10.5 million are included in other assets and are being amortized to interest expense over the term of the notes. Had these securities been issued at the beginning of the calendar year, the additional interest expense and issuance costs associated with the securities would have had no effect on the reported basic and diluted net

loss per share of $0.72 for the three months ended September 30, 2001 and would have increased the basic and diluted net loss per share to $0.83 for the nine months ended September 30, 2001.

In September 2001, our Board of Directors approved a multi-year stock buyback program authorizing us to repurchase up to 50.0 million shares of our common stock. In the three months ended September 30, 2001, approximately 10.1 million shares of common stock were repurchased for an aggregate purchase price of approximately $52.2 million. These purchases were made in the period from September 17, 2001 through September 28, 2001 in accordance with the terms of the Emergency Orders Pursuant to Section 12(k)(2) of the Securities Exchange Act issued by the SEC beginning September 14, 2001. Pursuant to the stock buyback program approved by the Board, we remain authorized to repurchase up to 39.9 million additional shares of common stock.

In August 2001, we reacquired approximately 7.0 million shares of our common stock in a private transaction valued at approximately $38.0 million. We have retired these shares.

We currently anticipate that our available cash resources and credit will be sufficient to meet our presently anticipated working capital and capital expenditure requirements for at least the next 12 months. We may need to raise additional funds in order to support more rapid expansion, develop new or enhanced services and products, respond to competitive pressures, acquire complementary businesses or technologies or take advantage of unanticipated opportunities. Our future liquidity and capital requirements will depend upon numerous factors, including costs and timing of expansion of technology development efforts and the success of such efforts, the success of our existing and new service offerings and competing technological and market developments. Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties, and actual results could vary. If additional funds are raised through the issuance of equity securities, the percentage ownership of the shareowners in our company will be reduced, shareowners may experience additional dilution in net book value per share or such equity securities may have rights, preferences or privileges senior to those of the holders of our common stock. There can be no assurance that additional financing will be available when needed on terms favorable to our Company, if at all. See "Item 2. Risk Factors—We may need additional funds in the future which may not be available and which may result in dilution of the value of our common stock."

If adequate funds are not available on acceptable terms, we may be unable to develop or enhance our services and products, take advantage of future opportunities or respond to competitive pressures, any of which could harm our business. See "Item 2. Risk Factors—If we are unable to quickly introduce new products and services that satisfy changing customer needs, we could lose customers and have difficulty attracting new customers."

Cash provided by operating activities, net of effects of acquisitions, was $963.4 million for the nine months ended September 30, 2001. Cash provided by operating activities resulted primarily from an excess of the net sale/maturity of banking-related assets over purchases of banking-related assets of $447.1

million, an increase in brokerage-related liabilities in excess of assets, net of effects of acquisitions, of $279.5 million, an increase in restructuring liabilities of $118.4 million, depreciation, amortization and discount accretion of $117.9 million, and an increase in accounts payable, accrued and other liabilities of $88.9 million. Cash used in operating activities, net of effects of acquisitions and net of the effects of realized gains on the sale of available-for-sale securities, was $63.3 million for the nine months ended September 30, 2000. Cash used in operating activities resulted primarily from an increase in brokerage-related assets in excess of liabilities, net of effects of acquisitions, of $311.0 million, offset by an excess of the net sale/maturity of banking-related assets over purchases of banking-related assets of $162.6 million, an increase in accounts payable, accrued and other liabilities of $110.6 million, and depreciation, amortization and discount accretion of $76.7 million.

Cash used in investing activities was $1,131.3 million and $4,007.8 million for the nine months ended September 30, 2001 and 2000, respectively. For the nine months ended September 30, 2001, cash used in investing activities resulted primarily from an increase in loans receivable and purchases of property and equipment, partially offset by an excess of the net sale/maturity of investments over the purchases of investments. For the nine months ended September 30, 2000, cash used in investing activities resulted primarily

from an increase in loans receivable, purchases of property and equipment, and an excess of the purchases of investments over the net sale/maturity of investments.

Cash provided by financing activities was $1,457.7 million and $4,178.2 million for the nine months ended September 30, 2001 and 2000, respectively. For the nine months ended September 30, 2001, cash provided by financing activities primarily resulted from an increase in banking deposits, net advances from the FHLB, and proceeds from the issuance of subordinated debt, offset by payments on advances from the FHLB and a decrease in securities sold under agreements to repurchase. For the nine months ended September 30, 2000, cash provided by financing activities primarily resulted from an increase in banking deposits, net advances from the FHLB, proceeds from the issuance of subordinated debt, and an increase in securities sold under agreements to repurchase, offset by payments on advances from the FHLB.

Recent Developments

September 11, 2001 Events

On September 11, 2001 the World Trade Center Towers in New York City were destroyed and the Pentagon in Arlington, Virginia was severely damaged by terrorist activities. These events did not directly impact our operational capacity. Our facilities and operations in New York and Arlington, Virginia were not damaged by the attacks. These tragic events resulted in the closing of U.S. financial markets for an unprecedented four days, disrupting the financial services industry and the economy in general. Since September 11, there have been numerous instances of harmful biological agents having been sent through the postal system. The events of September 11, 2001 and after may result in disruption to the markets or our ability to process transactions on a timely basis or further decreased investor activity, which may impact our operating results.

Acquisition of Dempsey

On October 1, 2001, we acquired Dempsey, an Illinois limited liability company which is a privately-held specialist and market-making firm, for an aggregate purchase price of approximately $178.5 million, comprised of approximately 28.9 million shares of our common stock valued at $153.4 million, $20.0 million in cash and direct acquisition costs preliminarily estimated to be $5.0 million. The acquisition will be accounted for using the purchase method of accounting, and the results of Dempsey's operations will be combined with our operations from the date of acquisition. The purchase price exceeded the fair value of the tangible assets acquired by approximately $165.0 million, as determined by a preliminary valuation assessment. Of the excess of the purchase price over the tangible assets, approximately 40% to 50% will be preliminarily allocated to specialist books representing a revocable license to trade and serve as a specialist for certain securities with the approval of the Chicago Stock Exchange, and the remainder has been preliminarily allocated to goodwill. The value allocated to specialist books will be amortized over 30 years on a straight-line basis. Estimates regarding our purchase price allocation are preliminary and are based on the estimated fair value of tangible and intangible assets acquired, subject to a valuation appraisal which is currently being conducted.

Legal Proceedings

In the ordinary course of our business, we engaged in certain stock loan transactions with MJK involving the lending of Nasdaq-listed common stock of GENI and other securities from MJK to us. Subsequently, we relent the GENI securities received from MJK to three other broker-dealers, Wedbush, Nomura and Fiserv. On September 25, 2001, Nasdaq halted trading in the stock of GENI, which had last traded at a price of $5.90 before the halt. As a result, MJK was unable to meet its collateral requirements on the GENI and other securities with certain counterparties to those transactions. MJK was ordered to cease operations by the SEC because they failed to meet regulatory capital requirements, and was placed into SIPC liquidation in the District of Minnesota. These events have led to disputes among several of the participants in the stock loan transactions involving the stock of GENI and other securities lent by MJK regarding which entities should bear the losses resulting from MJK's insolvency. We are confident that E*TRADE Securities has sufficient capital in excess of regulatory requirements to cover any potential exposure arising from these matters.

We have worked with the participants and regulatory agencies to resolve these disputes, but to date the disputes have not been resolved. Wedbush, Nomura, and Fiserv have commenced separate legal actions against

us. These actions seek various forms of equitable relief and seek repayment of a total of approximately $60.0 million received by us in connection with the GENI and other transactions. We believe that the plaintiffs must look to MJK as the debtor for repayment, and that we have defenses in each of these actions and will vigorously defend ourselves in all matters. To date, we have successfully defeated all actions for interim relief or have entered into consent orders essentially maintaining the status quo between the parties until the matter can be judicially resolved. Because the litigation is in its early stages, we are unable to predict the ultimate outcome or the amount of any potential losses.

Power Crisis in California

We have undertaken the following measures to protect our business and operations from rolling power blackouts in California and elsewhere and also from other natural disasters:

- We maintain duplicative trading centers in Rancho Cordova, California and Alpharetta, Georgia, which are operated on a 24 x 7 x 365-day a year basis. Ordinarily both trading centers are in operation, handle live trading traffic and keep duplicate records for all trades. In the event of a power shortage or other natural disaster, we are able to divert all trading traffic to either our Rancho Cordova or Alpharetta facilities within a matter of minutes.
- We maintain back-up generators to support all critical buildings that directly support our trading operations and our customer service areas in both our Rancho Cordova and Alpharetta locations. Supplementing these generators, we maintain battery sources that can power our trading operations for up to thirty minutes to permit our back-up generators to start, and, if our back-up generators fail, to allow us sufficient time to divert trading traffic to the duplicate live trading center.
- We also maintain disaster recovery policies and have implemented weekly checks of our Rancho Cordova power generators. To date, our power generators have not failed to respond in an appropriate manner.

We feel the possibility of power blackouts in California and elsewhere should not be a material risk to our business because of the redundant processes and back-up systems described above.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS, No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after December 15, 2001. SFAS No. 141 requires that all business combinations initiated after September 30, 2001 be accounted for under the purchase method of accounting and addresses the initial recognition and measurement of goodwill and intangible assets acquired in the business combination and the accounting for goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that goodwill and intangible assets with indefinite lives will not be amortized, but will rather be tested at least annually for impairment. We will adopt SFAS No. 142 for our fiscal year beginning January 1, 2002. Upon adoption of SFAS No. 142, we will stop the amortization of goodwill with an estimated net carrying value of approximately $416.6 million at December 31, 2001 and annual amortization expense of $26.2 million that resulted from business combinations initiated prior to the adoption of SFAS No. 141. Goodwill acquired subsequent to June 30, 2001 is not amortized. Accordingly, we will apply the purchase method of accounting to the acquisition of Dempsey and goodwill will not be amortized. We will evaluate goodwill under the SFAS No. 142 transitional impairment test, and we have not yet determined whether or not there is an impairment loss. Any transitional impairment loss will be recognized as a change in accounting principle.

In October 2001, the Financial Accounting Standards Board issued SFAS, No. 144, *Impairment on Disposal of Long-Lived Assets*, effective for fiscal years beginning after December 15, 2001. Under the new rules, the criteria required for classifying an asset as held-for-sale have been significantly changed. Assets held-for-sale are stated at the lower of their fair values or carrying amounts and depreciation is no longer recognized. In addition, the expected future operating losses from discontinued operations will be displayed in discontinued operations in the period in which the losses are incurred rather than as of the measurement date. More dispositions will qualify for discontinued operations treatment in the income statement under the new rules. We are currently evaluating the impact of SFAS No. 144 to our consolidated financial statements.

RISK FACTORS

RISKS RELATING TO THE NATURE OF THE ONLINE FINANCIAL SERVICES BUSINESS

We face competition from competitors, some of whom have significantly greater financial, technical, marketing and other resources, which could cause us to lower our prices or to lose a significant portion of our market share

The market for financial services over the Internet is new, rapidly evolving and intensely competitive. We expect competition to continue and intensify in the future. We face direct competition from financial institutions, brokerage firms, banks, specialists, market-makers, electronic communication networks (or ECNs), mutual fund companies, Internet portals, equity compensation product providers and other organizations, including among others:

- American Express Company
- AOL Time Warner Inc.
- Ameritrade, Inc.
- Bank of America Corporation
- bankone.com (a division of Bank One Corp.)
- Charles Schwab & Co., Inc. (including Schwab Capital Markets)
- CNBC MoneyCentral
- CSFBdirect (formerly DLJ direct)
- Citigroup Inc.
- Datek Online Financial Services LLC (a subsidiary of Datek Online Holdings Corporation)
- Deutsche Bank
- E-Loan, Inc.

- Fidelity Investments
- FleetBoston Financial Corporation
- Hoenig Group Inc.
- Instinet (a unit of Reuters Group)
- Intuit Inc.
- J.P. Morgan Chase & Co.
- Knight Securities (a division of Knight Trading Group, Inc.)
- Merrill Lynch, Pierce, Fenner & Smith Incorporated (including Herzog, Heine, Gould)
- Morgan Stanley Dean Witter & Co.
- National Discount Brokers Corporation (which was recently acquired by Ameritrade, Inc.)
- NetBank, Inc.
- PaineWebber Group, Inc. (which is owned by UBS AG)
- Salomon Smith Barney, Inc. (which is owned by Citigroup)
- Spear Leeds & Kellog (a division of Goldman Sachs Group, Inc.)
- TD Waterhouse Group, Inc.
- Transcentive, Inc.
- Wells Fargo & Company
- Yahoo! Inc.

Many of our competitors have longer operating histories and significantly greater financial, technical, marketing and other resources than we do. In addition, many of our competitors offer a wider range of

investment banking, advisory and other financial services and products than we do, and thus may be able to respond more quickly to new or changing opportunities, technologies and customer preferences and requirements. Many of our competitors also have greater name recognition and larger customer bases that could be leveraged, thereby gaining market share from us. These competitors may conduct more extensive promotional activities and offer better terms and lower prices to customers than we do, possibly even sparking a price war in the online financial services industry. Moreover, some of our competitors have established cooperative relationships among themselves or with third parties to enhance their services and products. It is possible that new competitors or alliances among existing competitors may significantly reduce our market share.

Commercial banks and other financial institutions have become more competitive with our brokerage operations by offering their customers certain corporate and individual financial services traditionally provided by securities firms. The current trend toward consolidation in the commercial banking industry could further increase competition in all aspects of our business. While we cannot predict the type and extent of competitive services that commercial banks and other financial institutions ultimately may offer, we may be harmed by such competition. To the extent our competitors are able to attract and retain customers, our business or ability to grow could be harmed.

There can be no assurance that we will be able to compete effectively with current or future competitors or that this competition will not significantly harm our business.

If we do not act or are unable to take advantage of consolidation opportunities in the online financial services industry, we could be at a competitive disadvantage, or lose our independence

Over the past few months, there has been significant consolidation in the online financial services industry and the consolidation is likely to continue and even accelerate in the future. Should we fail to or be unable to take advantage of viable consolidation opportunities we would be placed at a disadvantage relative to our competitors who have taken appropriate advantage of these opportunities.

The security of our computers could be breached or confidential customer information transmitted over public networks could be breached or misused, which could deter customers from using our services and significantly damage our reputation

Because we rely heavily on electronic communications and secure transaction processing in our securities, banking and ATM businesses, we must protect our computer systems and network from physical break-ins, security breaches and other disruptions caused by unauthorized access. We must also provide for the secure transmission of confidential information over public networks and prevent unauthorized use of confidential customer information. The open nature of the Internet makes protecting against these threats more difficult. Unauthorized access to our computers, could jeopardize the security of information stored in and transmitted through our computer systems and network, which could harm our ability to retain or attract customers, damage our reputation and subject us to litigation and financial losses. We have in the past, and could in the future, be subject to denial of service, vandalism and other attacks on our systems. We rely on encryption and authentication technology, including cryptography technology licensed from RSA Data Security, Inc., to provide secure transmission of confidential information over public networks. Advances in computer and decryption capabilities or other developments could compromise the methods we use to protect customer transaction data, which could harm our ability to retain or attract customers. In addition, we must guard against damage, fraud, embezzlement and unauthorized trading by persons with authorized access to our computer systems, including individuals employed by us. The security and encryption technology and the operational procedures we implement to prevent break-ins, damage and failures may be unable to prevent future disruptions of our operations. Our insurance coverage may be insufficient to cover losses that may result from these events.

As a significant portion of our revenues come from online investing services, downturns in the securities industry have harmed and could further significantly harm our business, including by reducing transaction volumes and margin borrowing and increasing our dependence on our more active customers who receive lower prices

A significant portion of our revenues in recent years has been from online investing services, and although we continue to diversify our revenue sources, we expect this business to continue to account for a significant portion of our revenues in the foreseeable future. We, like other financial services firms, are directly affected by economic and political conditions, broad trends in business and finance and changes in volume and price levels of securities and futures transactions. The terrorist attacks in the United States on September 11, 2001, for example, resulted in the closing of U.S. financial markets for an unprecedented four days and may result in the continuation of market volatility and decreased investor activity referred to below. The U.S. securities markets are characterized by considerable fluctuation and downturns in these markets have harmed our operating results, including our transaction volume and the rate of growth of new accounts, and could continue to do so in the future. Significant downturns in the U.S. securities markets occurred in October 1987 and October 1989, and a significant downturn has been occurring since March 2000. Consequently, transaction volume has decreased industry-wide including a substantial decrease in the past quarter, and many broker-dealers, including E*TRADE Securities, have been adversely affected. The decrease in transaction volume has been more significant with respect to our less active customers, increasing our dependence on our more active Power E*TRADE customers who receive more favorable pricing based on their transaction volume. When transaction volume is low, our operating results are harmed in part because some of our overhead costs remain relatively fixed. We cannot assure you that U.S. securities markets will not continue to be volatile or that prices and transaction volumes will not continue to move downward, either of which could harm our business going forward. Some of our competitors with more diverse product and service offerings might withstand such a downturn in the securities industry better than we would. See “Item 2. Risk Factors—We face competition from competitors, some of whom have significantly greater financial, technical, marketing and other resources, which could cause us to lower our prices or to lose a significant portion of our market share.”

Downturns in the securities markets increase the risk that parties to margin lending or stock loan transactions with us will fail to honor their commitments and that the value of the collateral we hold in connection with those transactions will not be adequate, increasing our risk of losses from our margin lending or stock loan activities

We sometimes allow customers to purchase securities on margin, and we are therefore subject to risks inherent in extending credit. This risk is especially great when the market is rapidly declining and the value of the collateral we hold could fall below the amount of a customer’s indebtedness. Similarly, as part of our broker-dealer operations, we frequently enter into arrangements with other broker-dealers for the lending of various securities. Under specific regulatory guidelines, any time we borrow or lend securities, we must correspondingly disburse or receive cash deposits. If we fail to maintain adequate cash deposit levels at all times, we run the risk of loss if there are sharp changes in market values of many securities and parties to the borrowing and lending transactions fail to honor their commitments. The significant downturn in equity markets since its record high in March 2000 has led to a greater risk that parties to stock lending transactions may fail to meet their commitments. Any such losses could harm our financial position and results of operations.

An inability to retain and hire skilled personnel and senior management could seriously harm our ability to maintain and grow our business

If the number of accounts and transaction volume increases significantly over current volume, there could be a shortage of qualified and, in some cases, licensed personnel that we may then be seeking to hire which could cause a backlog in the handling of banking transactions or the processing of brokerage orders that need review, and that could harm our business, financial condition and operating results. Competition for such personnel is intense when trading volumes are high, and there can be no assurance that we will be able to retain or hire technical persons or licensed representatives in the future.

In addition, our future success depends to a significant degree on the skills, experience and efforts of our Chairman and Chief Executive Officer, President and Chief Customer Operations Officer, Members of the Office of the President and Managing Directors, Chief Finance and Administration Officer, our Board of Directors, and other key management personnel. The loss of the services of any of these individuals could compromise our ability to effectively operate our business.

If our ability to correctly process customer transactions is slowed or interrupted, we could be subject to customer litigation and our reputation could be harmed

We process customer transactions mostly through the Internet, online service providers, touch-tone telephones, our ATM network, and our computer systems, and we depend heavily on the integrity of the communications and computer systems supporting these transactions, including our internal software programs and computer systems. A degradation or interruption in the operation of these systems, including any such degradation or interruption that is part of a widespread, concerted terrorist attack could cause substantial customer losses and subject us to significant customer litigation and could materially harm our reputation. Our systems or any other systems in the transaction process could slow down significantly or fail for a variety of reasons including:

- undetected errors in software programs or computer systems,
- our inability to effectively resolve any errors in our internal software programs or computer systems once they are detected, or
- heavy stress placed on systems in the transaction process during certain peak trading times.

In addition, we have recently consolidated certain of our computer systems to provide for operational efficiencies. This consolidation has reduced the redundancies that were inherent in our systems to lessen or avoid the effects of interruptions in certain of our systems. If our systems or any other systems in the transaction process slow down or fail even for a short time, our customers could suffer delays in transaction processing, which could cause substantial customer losses and may subject us to claims for these losses or to litigation. The NASDR defines a "system failure" as a shutdown of our mission critical systems (defined as those necessary for the acceptance and execution of online securities orders) which causes the customers' use of these systems to equal or exceed system capacity during regular market hours, or a shutdown of any system application necessary for the acceptance and execution of online securities orders for a period of 15 continuous minutes that affects 25% or more of the customers on the system from effecting securities transactions during regular market hours. We have experienced systems failures and degradation in the past. Systems failures and degradations could occur with respect to U.S. markets or foreign markets where we must implement new transaction processing infrastructures. To date, during our systems failures, we were able to take orders by telephone; however, with respect to our brokerage transactions, only associates with securities brokers' licenses can accept telephone orders. An adequate number of such associates may not be available to take customer calls in the event of a future systems failure, and we may not be able to increase our customer service personnel and capabilities in a timely and cost-effective manner. To promote customer satisfaction and protect our brand name, we have, on certain occasions, compensated customers for verifiable losses from such failures.

Tampering with or interrupting our mail delivery system on a national or company-wide basis could cause harm to our associates or interfere with our ability to provide transactions on a timely basis

In recent weeks, there have been significant illegal acts involving the sending of harmful biological substances through the United States postal system. To date, this has resulted in disruptions to the delivery of mail, and in the future, the fear of "bio-terrorism" could impact our ability to process mail, whether by our own associates, third party vendors or the U.S. Postal System. A number of our transactions, including the opening and initial funding of bank and brokerage accounts, are initiated by forms that are mailed to us for processing. A disruption of the delivery or processing of mail or our receipt of harmful substances sent by mail, could cause harm to our associates or other service providers and interfere with our ability to timely process transactions, which could harm our business.

If we are unsuccessful in managing the effects of changes in interest rates, our financial condition and results of operations could suffer.

The results of operations for the Bank depend in large part upon the level of its net interest income, that is, the difference between interest income from interest-earning assets, such as loans and mortgage-backed securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. Changes in market interest rates (and the yield curve) could reduce the value of the Bank's financial assets and thereby reduce net interest income. Fixed-rate investments, mortgage-backed and related securities and mortgage loans generally decline in value as interest rates rise. Many factors affect interest rates, including governmental monetary policies and domestic and international economic and political conditions. Currently, the Bank's net interest income is harmed by falling interest rates. However, as the Bank's ratio of interest-earning assets to interest-bearing liabilities changes, the risk of falling interest rates will also be affected.

The Bank attempts to mitigate this interest rate risk by using derivative contracts that are designed to offset, in whole or in part, the variability in value or cash flow of various assets or liabilities caused by changes in interest rates. There can be no assurances that these derivative contracts move either directionally or proportionately as intended. SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which we adopted on October 1, 2000, requires that the hedge ineffectiveness, or the difference between the change in value of the hedged item versus the change in value of the hedging instruments, be recognized in earnings as of the reporting date. Our financial results may prove to be more volatile due to this new reporting requirement.

The Bank's diversification of its asset portfolio to include higher yielding investments which carry a higher inherent risk of default in its portfolio may increase the risk of charge-offs which could reduce our profitability

As the Bank diversifies its asset portfolio through purchases of new higher yielding asset classes, such as auto loans and recreational vehicle loans, we will have to manage assets that carry a higher inherent risk of default than experienced with our existing portfolio. Consequently, the level of charge-offs associated with these assets may be higher than previously experienced. If expectations of future charge-offs increase, a simultaneous increase in the amount of our loss reserves would be required. The increased level of charge-offs recorded to meet additional reserve requirements could harm the results of our operations if those higher yields do not cover the charge-offs.

We rely on a number of third parties to process our transactions, and their inability to expand their technology to meet our needs, or our inability to expand our own technology in the event of a significant increase in demand, could impair our ability to acquire new customers and otherwise grow our business

We rely on a number of third parties to process our transactions, including online and Internet service providers, back office processing organizations, market-makers and other service providers, all of which may need to expand the scope of the operations they perform for us. Any backlog caused by a third party's inability to expand sufficiently to meet our needs could harm our business. In addition, rapid growth in the use of our services could strain our own ability to adequately expand technologically to meet increased demand.

If we are unable to quickly introduce new products and services that satisfy changing customer needs, we could lose customers and have difficulty attracting new customers

Our future profitability depends significantly on our ability to innovate by developing and enhancing our services and products. There are significant challenges to such development and enhancement, including technical risks. There can be no assurance that we will be successful in achieving any of the following:

- effectively using new technologies,
- adapting our services and products to meet emerging industry standards,

- developing, introducing and marketing service and product enhancements, or
- developing, introducing and marketing new services and products to meet customer demand.

Additionally, these new services and products, if they are developed, may not adequately meet the requirements of the marketplace or achieve market acceptance. If we are unable to develop and introduce enhanced or new services and products quickly enough to respond to market or customer requirements, or if they do not achieve market acceptance, our business could be harmed.

Risks associated with trading transactions at our specialist/market-maker could result in trading losses

A majority of our specialist and market-maker revenues at Dempsey are derived from trading by Dempsey as a principal. Dempsey may incur trading losses relating to the purchase, sale or short sale of securities for its own account. In any period, Dempsey also may incur trading losses in its specialist stocks and market-maker stocks for reasons such as price declines, lack of trading volume and the required performance of specialist and market-maker obligations. From time to time, Dempsey may have large position concentrations in securities of a single issuer or issuers engaged in a specific industry. In general, because Dempsey's inventory of securities is marked to market on a daily basis, any downward price movement in those securities will result in a reduction of our revenues and operating profits. Dempsey also operates a proprietary trading desk separately from its specialist and market-maker operations. We may incur trading losses as a result of these trading activities.

Although we have adopted risk management policies at Dempsey, we cannot be sure that these policies have been formulated properly to identify or limit Dempsey's risks. Even if these policies are formulated properly, we cannot be sure that we will successfully implement these policies at Dempsey. As a result, we may not be able to manage our risks successfully or avoid trading losses at Dempsey.

Trading through market-makers and/or specialists could be reduced which could reduce Dempsey's revenues

Alternative trading systems could reduce the levels of trading of exchange-listed securities through specialists and could reduce the levels of over-the-counter trading through market-makers, harming Dempsey's revenues and, in turn, our revenues.

Over the past few years, a number of alternative trading systems have developed or emerged which compete with specialists by increasing trading in exchange-listed securities off the exchange trading floor and in over-the-counter markets. We cannot assure you that these developments will not cause a decrease in the transaction volumes of Dempsey's specialist operations.

In addition, ECNs have emerged as an alternative forum to which broker-dealers and institutional investors can direct their limit orders. This allows them to avoid directing their trades through market-makers. As a result, Dempsey may experience a reduction in its flow of limit orders. We cannot assure you that ECNs will not continue to capture a greater amount of limit order flow.

Reduced spreads in securities pricing, and levels of trading activity could harm our specialist and market-maker businesses

The listed marketplaces other than Nasdaq moved from trading using fractional share prices to trading using decimals in January 2001, and the Nasdaq initiated decimalization in March 2001. As a result, spreads that specialists and market-makers receive in trading equity securities have declined and may continue to decline, which could harm revenues generated by Dempsey and, in turn, our operating results. Similarly, a reduction in the volume and/or volatility of trading activity could also reduce spreads that specialists and market-makers receive, also harming revenues generated by Dempsey and, in turn, our operating results.

If our Business Solutions Group products fail, we could be subject to litigation and our reputation may be harmed

BSG provides products and services to assist companies to work effectively with their own legal, accounting and tax advisors to comply with the laws, regulations, and rules pertaining to equity compensation. BSG provides products and services that, by their nature, are highly technical and intricate, and that deal with issues which could result in significant accounting and tax reporting inaccuracies. If BSG's efforts to protect itself from liability arising from product design limitations and/or potential human error prove inadequate, these inaccuracies could subject us to customer litigation and damage our reputation.

The size of our market and our results of operations depend heavily upon the growing acceptance of the Internet as a commercial marketplace for financial services

Because the electronic provision of financial services is currently the most significant part of our business, sales of most of our services and products will depend on consumers continuing to adopt the Internet as a method of doing business and, in particular, as a method of obtaining financial services. Several factors could adversely affect the acceptance and growth of online commerce. For example, there can be no assurance that the Internet infrastructure will continue to be able to support the demands placed on it by growing usage. In addition, the Internet could be adversely affected by the slow development or adoption of standards and protocols to handle increased Internet activity or by increased governmental regulation. Moreover, critical Internet issues including privacy, security, reliability, cost, ease of use, accessibility and quality of service remain unresolved, which could negatively affect the growth of Internet use or commerce on the Internet.

Even if Internet commerce grows generally, the online market for financial services could grow more slowly or even shrink in size. Adoption of online commerce for financial services by individuals who have relied upon traditional delivery channels in the past will require such individuals to accept new and different methods of conducting business. Consumers who trade with traditional brokerage firms, or even discount brokers, may be reluctant or slow to change to obtaining brokerage services over the Internet. Consumers who are most comfortable conducting their banking business in person at a branch office may be unwilling to bank online or may find doing business with an online bank to be less convenient due to the bank's lack of a physical presence near where they work or live. Also, concerns about security and privacy on the Internet may hinder the growth of online investing and banking, which could harm our business.

If our international efforts are not successful, our business growth will be harmed and our resources will not have been used efficiently

One component of our strategy is a planned increase in efforts to attract more international customers. To date, we have limited experience in providing brokerage services internationally, and ETFC has had only limited experience providing banking services to customers outside the United States. There can be no assurance that we and/or our international licensees will be able to market our branded services and products successfully in international markets.

In order to expand our services globally, we must comply with the regulatory controls of each specific country in which we conduct business. Our international expansion could be limited by the compliance requirements of other regulatory jurisdictions, including the European Union's Privacy Directive regulating the use and transfer of customer data. We intend to rely primarily on local third parties and our subsidiaries for regulatory compliance in foreign jurisdictions.

In addition, there are certain risks inherent in doing business in international markets, particularly in the heavily regulated brokerage and banking industries, such as:

- unexpected changes in regulatory requirements and trade barriers,
- difficulties in staffing and managing foreign operations,

- the level of investor interest in cross-border trading,
- authentication of online customers,
- political instability,
- fluctuations in currency exchange rates,
- reduced protection for intellectual property rights in some countries,
- possible fraud, embezzlement or unauthorized trading by our associates,
- seasonal reductions in business activity during the summer months in Europe and certain other parts of the world,
- the level of acceptance and adoption of the Internet in international markets, and
- potentially adverse tax consequences.

Any of the foregoing could harm our international operations. In addition, because some of these international markets are served through license arrangements with others, we rely upon these third parties for a variety of business and regulatory compliance matters. We have limited control over the management and direction of these third parties. We run the risk that their action or inaction could harm our operations and/or our reputation. Additionally, certain of our international licensees have the right to grant sublicenses. Generally, we have less control over sublicensees than we do over licensees. As a result, the risk to our operations and goodwill is higher.

Our failure to successfully integrate the companies that we acquire into our existing operations could harm our business

We recently acquired E*TRADE Access, Electronic Investing Corporation, PrivateAccounts Inc. (renamed E*TRADE Advisory Services, Inc. on January 2, 2001), E*TRADE Technologies, LoansDirect, Inc. (which merged into and changed its name to E*TRADE Mortgage Corporation on June 15, 2001), Web Street, several of our international affiliates and Dempsey. We may also acquire other companies or technologies in the future, and we regularly evaluate such opportunities. Acquisitions entail numerous risks, including, but not limited to:

- difficulties in the assimilation and integration of acquired operations and products,
- diversion of management’s attention from other business concerns,
- failure to achieve anticipated cost savings,
- failure to retain existing customers of the acquired companies,
- amortization of acquired intangible assets, with the effect of reducing our reported earnings, and
- potential loss of key associates of acquired companies.

No assurance can be given as to our ability to integrate successfully any operations, technology, personnel, services or new businesses or products that might be acquired in the future. Failure to successfully assimilate acquired organizations could harm our business. In addition, there can be no assurance that we will realize a positive return on any of these investments.

We have substantially increased our indebtedness, which may make it more difficult to make payments on our debts or to obtain financing

As a result of our sale in May 2001 of $325 million in 6.75% convertible subordinated notes offset by the exchange transactions which in the aggregate resulted in the retirement of $90.0 million of our 6% convertible subordinated notes in June through September 2001, and the open market repurchase in the aggregate of

$25.0 million of 6% convertible subordinated notes in September 2001, we have incurred $210 million of additional convertible indebtedness. Combined with a decrease in a shareowner’s equity from March 31, 2001 reflecting the facility restructuring and nonrecurring charge and the effects of the share buyback program, our ratio of debt to equity (expressed as a percentage) increased from approximately 41% as of March 31, 2001 to approximately 60% as of September 30, 2001. We may incur additional indebtedness in the future. The level of our indebtedness, among other things, could:

- make it more difficult to make payments on our debt,

- make it more difficult or costly for us to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes,
- limit our flexibility in planning for or reacting to changes in our business, and
- make us more vulnerable in the event of a downturn in our business.

Any failure to maintain our relationships with strategic partners or loss in value of the investments we make could harm our business

We have established a number of strategic relationships and alliances with online and Internet service providers, investment banking and financial service providers, market-makers and other vendors. There can be no assurance that each of these relationships or alliances will be maintained or that, if a relationship is maintained, it will be successful or profitable. There can be no assurance that the terms of any relationship or alliance with another party will be honored by that party. Additionally, we may not be able to develop new relationships or alliances of this type in the future.

We also make investments, either directly or through affiliated private investment funds, in equity securities of other companies without acquiring control of those companies. There may be no public market for the securities of the companies in which we invest, and we may not be able to sell these securities at a profit, or at all. We have in the past been required to write down the value of our investments in equity securities of other companies.

If we fail to protect our intellectual property rights or face a claim of intellectual property infringement by a third party, we could lose our intellectual property rights, be liable for significant damages, or incur significant costs and expenses regardless of the merits of the claims against us

Our ability to compete effectively is dependent to a significant degree on our brand and proprietary technology. We rely primarily on copyright, trade secret and trademark law to protect our technology and our brand. Effective trademark protection may not be available for our trademarks. Although we have registered the trademark “E*TRADE” in the United States and a number of other countries, and have other registered trademarks, there can be no assurance that we will be able to secure significant protection for these trademarks. Our competitors or others may adopt product or service names similar to “E*TRADE,” thereby impeding our ability to build brand identity and possibly leading to customer confusion. Our inability to adequately protect the name “E*TRADE” or our other trademarks could harm our business. Despite any precautions we take, a third party may be able to copy or otherwise obtain and use our software or other proprietary information without authorization or to develop similar software independently. Policing unauthorized use of our technology is made especially difficult by the global nature of the Internet and difficulty in controlling the ultimate destination or security of software or other data transmitted on it. The laws of other countries may afford us little or no effective protection for our intellectual property. There can be no assurance that the steps we take will prevent misappropriation of our technology or that agreements entered into for that purpose will be enforceable. In addition, litigation may be necessary in the future to:

- enforce our intellectual property rights,
- protect our trade secrets,

- determine the validity and scope of the proprietary rights of others, or
- defend against claims of infringement or invalidity.

Such litigation, whether successful or unsuccessful, could result in substantial costs and divert resources, either of which could harm our business.

We have received in the past, and may receive in the future, notices of claims of infringement of other parties’ proprietary rights. There can be no assurance that claims for infringement or invalidity—or any indemnification claims based on such claims—will not be asserted or prosecuted against us. Any such claims, with or without merit, could be time consuming and costly to defend or litigate, divert our attention and resources or require us to enter into royalty or licensing agreements. There can be no assurance that such licenses would be available on reasonable terms, if at all.

Our efforts to expand recognition of the E*TRADE brand to areas of the financial services industry other than online trading may not be effective

As we diversify the scope of the products and services we offer, the brand “E*TRADE” may not be as effective for us in the future, which could harm our revenues. Further, any efforts to expand or modify the brand to more accurately reflect the diversified nature of our product offerings may not achieve widespread acceptance. In addition, our efforts to further our brand as a diversified financial services institution are largely dependent on our use of effective marketing and advertising efforts. If these efforts are not successful, we will not have used resources effectively.

Provisions in our certificate of incorporation and bylaws, our stockholder rights plan, stock incentive plans, contracts and management continuity agreements and Delaware law could prevent or delay an acquisition of us that a shareowner may consider to be favorable

Certain provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a third party from acquiring control of us in a merger, acquisition or similar transaction that a shareowner may consider favorable. Such provisions include:

- authorization for the issuance of “blank check” preferred stock,
- provision for a classified board of directors with staggered, three-year terms,
- the prohibition of cumulative voting in the election of directors,
- a super-majority voting requirement to effect business combinations or certain amendments to our certificate of incorporation and bylaws,
- limits on the persons who may call special meetings of shareowners,
- the prohibition of shareowner action by written consent, and

- advance notice requirements for nominations to the board of directors or for proposing matters that can be acted on by shareowners at shareowner meetings.

Attempts to acquire control of us may also be delayed or prevented by our stockholder rights plan. The stockholder rights plan is designed to enhance the ability of our Board of Directors to protect shareowners against, among other things, unsolicited attempts to acquire control of us that do not offer an adequate price to all shareowners or are otherwise not in the best interests of us and our shareowners. In addition, certain provisions of our stock incentive plans, management continuity and employment agreements and Delaware law may also discourage, delay or prevent someone from acquiring or merging with us.

RISKS RELATING TO THE REGULATION OF OUR BUSINESS

If changes in government regulation, including banking and securities rules and regulations, favor our competition or restrict our business practices, our ability to attract and retain customers and our profitability may suffer

The securities industry in the United States is subject to extensive regulation under both federal and state laws. The banking industry in the United States is subject to extensive federal regulation. Broker-dealers are subject to regulations covering all aspects of the securities business, which include:

- sales methods,
- recommendations of securities,
- trading practices among broker-dealers,
- execution of customers' orders,
- use and safekeeping of customers' funds and securities,
- capital structure,
- record keeping,
- advertising,
- conduct of directors, officers and employees, and
- supervision.

Because we are a self-clearing broker-dealer, we have to comply with many additional laws and rules. These include rules relating to possession and control of customer funds and securities, margin lending and execution and settlement of transactions. Our ability to comply with these rules depends largely on the establishment and maintenance of a qualified compliance system. We are also subject to additional laws and rules as a result of our specialist and market-maker operations in Dempsey.

Similarly, E*TRADE and ETFC, as savings and loan holding companies, and the Bank, as a federally chartered savings bank and subsidiary of ETFC, are subject to extensive regulation, supervision and examination by the OTS, and, in the case of the Bank, the FDIC. Such regulation covers all aspects of the banking business, including lending practices, safeguarding deposits, capital structure, record keeping, transactions with affiliates, and conduct and qualifications of personnel.

Because of our international presence, we are also subject to the regulatory controls of each specific country in which we conduct business.

Because we operate in an industry subject to extensive regulation, the competitive landscape in our industry can change significantly as a result of new regulation, changes in existing regulation, or changes in the interpretation or enforcement of existing laws and rules. For example, in November 1999, the Gramm-Leach-Bliley Act was enacted into law. This act reduces the legal barriers between banking, securities and insurance companies, and will make it easier for financial holding companies to compete directly with our securities business, as well as for our competitors in the securities business to diversify their revenues and attract additional customers through entry into the banking and insurance businesses. The Gramm-Leach-Bliley Act may have a material impact on the competitive landscape that we face. Similarly, in February 2001, the Securities Exchange Commission approved amendments to NASD Rule 2520 governing margin requirements for "pattern day traders" which became effective September 28, 2001. Among other requirements, these amendments will require "pattern day traders" to have deposited in their accounts a minimum equity of $25,000 on any day in which the customer day trades. The amendments to NASD Rule 2520 could affect the behavior of certain of our most active customers and negatively impact our revenues.

There can be no assurance that federal, state or foreign agencies will not further regulate our business. We anticipate that we may be required to comply with record keeping, data processing and other regulatory requirements as a result of proposed federal legislation or otherwise. We may also be subject to additional regulation as the market for online commerce evolves. Because of the growth in the electronic commerce market, Congress has held hearings on whether to regulate providers of services and transactions in the electronic commerce market. As a result, federal or state authorities could enact laws, rules or regulations affecting our business or operations. We may also be subject to federal, state or foreign money transmitter laws and state and foreign sales or use tax laws. If such laws are enacted or deemed applicable to us, our business or operations could be rendered more costly or burdensome, less efficient or even impossible. Any of the foregoing could harm our business, financial condition and operating results.

If we fail to comply with applicable securities and banking regulations, we could be subject to disciplinary actions, damages, penalties or restrictions that could significantly harm our business

The SEC, the NASDR or other self-regulatory organizations and state securities commissions can censure, fine, issue cease-and-desist orders or suspend or expel a broker-dealer or any of its officers or employees. The OTS may take similar action with respect to our banking activities. Our ability to comply with all applicable laws and rules is largely dependent on our establishment and maintenance of a system to ensure such compliance, as well as our ability to attract and retain qualified compliance personnel. We could be subject to disciplinary or other actions due to claimed noncompliance in the future, which could harm our business.

If we do not maintain the capital levels required by regulators, we may be fined or forced out of business

The SEC, NASDR, OTS and various other regulatory agencies have stringent rules with respect to the maintenance of specific levels of net capital by securities broker-dealers and regulatory capital by banks. Net capital is the net worth of a broker or dealer (assets minus liabilities), less deductions for certain types of assets. If a securities firm fails to maintain the required net capital it may be subject to suspension or revocation of registration by the SEC and suspension or expulsion by the NASDR, and could ultimately lead to the firm's liquidation. In the past, our broker-dealer subsidiaries have depended largely on capital contributions by us in order to comply with net capital requirements. If such net capital rules are changed or expanded, or if there is an unusually large charge against net capital, operations that require the intensive use of capital could be limited. Such operations may include investing activities, marketing and the financing of customer account balances. Also, our ability to withdraw capital from brokerage subsidiaries could be restricted, which in turn could limit our ability to pay dividends, repay debt and redeem or purchase shares of our outstanding stock. A large operating loss or charge against net capital could adversely affect our ability to expand or even maintain our present levels of business, which could harm our business.

The table below summarizes the minimum net capital requirements for our domestic broker-dealer subsidiaries as of September 30, 2001 (in thousands):

	Required Net Capital	Net Capital	Excess Net Capital
E*TRADE Securities	$32,503	$295,918	$263,415
E*TRADE Institutional Securities, Inc.	$ 258	$ 3,289	$ 3,031
E*TRADE Investor Select, Inc.	$ 5	$ 5	$ —
Marquette Securities, Inc.	$ 250	$ 500	$ 250
E*TRADE Global Asset Management, Inc.	$ 630	$ 12,140	$ 11,510
E*TRADE Canada Securities Corporation	$ 100	$ 295	$ 195
Web Street Securities and subsidiary	$ 817	$ 2,451	$ 1,634

Similarly, banks, such as the Bank, are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and

possibly additional discretionary, actions by regulators that, if undertaken, could harm a bank's operations and financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, a bank must meet specific capital guidelines that involve quantitative measures of a bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. A bank's capital amounts and classification are also subject to qualitative judgments by the regulators about the strength of components of the bank's capital, risk weightings of assets and off-balance-sheet transactions, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require a bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. To satisfy the capital requirements for a well capitalized financial institution, a bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table.

The table below summarizes the capital adequacy requirements for the Bank as of September 30, 2001 (dollars in thousands):

	Actual		Well Capitalized Requirements	
	Amount	Ratio	Amount	Ratio
Core Capital (to adjusted tangible assets)	$777,589	6.0%	$649,340	5.0%
Tier 1 Capital (to risk weighted assets)	$777,589	11.2%	$415,256	6.0%
Total Capital (to risk weighted assets)	$791,455	11.4%	$692,093	10.0%

Restrictions on the ability of, or decreased willingness of, third parties to make payments for order flow or potential payments by us to third parties for handling orders could reduce our profitability

Order flow revenue is comprised of rebate income from various market-makers and market centers for processing transactions through them. There can be no assurance that payments for order flow will continue to be permitted by the SEC, the NASDR or other regulatory agencies, courts or governmental units. In addition, the listed marketplaces other than Nasdaq moved from trading using fractional share prices to trading using decimals in January 2001 and the Nasdaq initiated decimalization in March 2001. With the advent of decimalization, certain market-makers have reduced payments for order flow, others have announced plans to reduce payments for order flow, and others are taking a "wait and see" approach. It is possible that some market-makers and market centers could begin charging companies that direct order flow to them. As a majority of our order flow revenues is derived from Nasdaq listed securities, we were negatively affected by decimalization during the quarter ended September 30, 2001. The impact of decimalization on future revenues cannot be accurately predicted at this time, and a continued, general decrease in these revenues is expected. Further, there can be no assurance that we will be able to continue our present relationships and terms for payments for order flow. Loss of any or all of these revenues could harm our business.

Specialist rules may require Dempsey to make unprofitable trades or to refrain from making profitable trades

Dempsey's role as a specialist, at times, requires it to make trades that adversely affect its profitability. In addition, as a specialist, Dempsey is at times required to refrain from trading for its own account in circumstances in which it may be to Dempsey's advantage to trade. For example, Dempsey may be obligated to act as a principal when buyers or sellers outnumber each other. In those instances, Dempsey may take a position counter to the market, buying or selling shares to support an orderly market in the affected stocks. In order to perform these obligations, Dempsey holds varying amounts of securities in inventory. In addition, specialists generally may not trade for their own account when public buyers are meeting public sellers in an orderly fashion and may not compete with public orders at the same price. By having to support an orderly market, maintain

inventory positions and refrain from trading under some favorable conditions, Dempsey is subject to a high degree of risk. Additionally, stock exchanges periodically amend their rules and may make the rules governing Dempsey's activities as a specialist more stringent or may implement other changes, which could adversely affect its trading revenues.

Regulatory review of our advertising practices could hinder our ability to operate our business and result in fines and other penalties

All marketing activities by E*TRADE Securities are regulated by the NASDR, and all marketing materials must be reviewed by an E*TRADE Securities Series 24 licensed principal prior to release. The NASDR has in the past asked us to revise certain marketing materials. In June 2001, we settled a formal NASDR investigation into our advertising practices and were fined by the NASDR in connection with three advertisements that were placed in 1999. The NASDR can impose certain penalties for violations of its advertising regulations, including:

- censures or fines,
- suspension of all advertising,
- the issuance of cease-and-desist orders, or
- the suspension or expulsion of a broker-dealer or any of its officers or employees.

In addition, the federal banking agencies impose restrictions on bank advertising of non-deposit investment products to minimize the likelihood of customer confusion.

If we were deemed to solicit orders from our customers or make investment recommendations, we would become subject to additional regulations that could be burdensome and subject us to fines and other penalties

If we were deemed to solicit orders from our customers or make investment recommendations, we would become subject to additional rules and regulations governing, among other things, sales practices and the suitability of recommendations to customers. Compliance with these regulations could be burdensome, and, if we fail to comply, we could be subject to fines and other penalties. We are continuing to develop technology, through a joint venture, that may enable us to provide financial advice for online investors in the future.

Due to the increasing popularity of the Internet, laws and regulations may be passed dealing with issues such as user privacy, pricing, content and quality of products and services, and those regulations could adversely affect the growth of the online financial services industry

As required by the Gramm-Leach-Bliley Act, the SEC and OTS have recently adopted regulations on financial privacy which took effect in July 2001 that will require E*TRADE Securities and the Bank to notify consumers about the circumstances in which they may share consumers' personal information with unaffiliated third parties and to give consumers the right to prohibit such information sharing in specified circumstances. Although E*TRADE Securities and the Bank already provide such opt-out rights in our privacy policies, the regulations required us to modify the text and the form of presentation of our privacy policies and will require us to incur additional expense to ensure ongoing compliance with the regulations.

In addition, several recent reports have focused attention on the online brokerage industry. For example, the New York Attorney General investigated the online brokerage industry and issued a report in November 1999, citing consumer complaints about delays and technical difficulties in companies conducting online stock trading. Then SEC Commissioner Laura Unger also issued a report in November 1999 on issues raised by online brokerage, including suitability and marketing issues. Most recently, the United States General Accounting Office issued a report citing a need for better investor protection information on brokers' Web sites and, on January 25, 2001, the SEC issued a report summarizing its findings and recommendations following an examination of broker-dealers offering online trading.

Increased attention focused upon these issues could hurt the growth of the online financial services industry, which could, in turn, decrease the demand for our services or otherwise harm our business.

Due to our acquisition of ETFC, we are subject to regulations that could restrict our ability to take advantage of good business opportunities and that may be burdensome to comply with

Upon the completion of our acquisition of ETFC and its subsidiary, the Bank, on January 12, 2000, we became subject to regulation as a savings and loan holding company. As a result, we, as well as the Bank, are required to file periodic reports with the OTS, and are subject to examination by the OTS. The OTS also has certain types of enforcement power over ETFC and us, including the ability to issue cease-and-desist orders, up to and including forcing divestiture of the Bank, and civil money penalties, for violating the Savings and Loan Holding Company Act. In addition, under the Graham-Leach-Bliley Act, our activities are now restricted to activities that are financial in nature and certain real estate-related activities. We may make merchant banking investments in companies whose activities are not financial in nature, if those investments are engaged in for the purpose of appreciation and ultimate resale of the investment and we do not manage or operate the company. Such merchant banking investments may be subject to maximum holding periods and special record keeping and risk management requirements.

We believe that all of our existing activities and investments are permissible under the new legislation, but the OTS has not yet interpreted these provisions. Even if all of our existing activities and investments are permissible, under the new legislation we will be constrained in pursuing future new activities that are not financial in nature. We are also limited in our ability to invest in other savings and loan holding companies. These restrictions could prevent us from pursuing certain activities and transactions that could be beneficial to us.

In addition to regulation of us and ETFC as savings and loan holding companies, federal savings banks such as the Bank are subject to extensive regulation of their activities and investments, their capitalization, their risk management policies and procedures, and their relationship with affiliated companies. In addition, as a condition to approving our acquisition of ETFC, the OTS imposed various notice and other requirements, primarily a requirement that the Bank obtain prior approval from the OTS of any future material changes to the Bank's business plan. Acquisitions of and mergers with other financial institutions, purchases of deposits and loan portfolios, the establishment of new Bank subsidiaries, and the commencement of new activities by Bank subsidiaries require the prior approval of the OTS. These regulations and conditions could place us at a competitive disadvantage in an environment in which consolidation within the financial services industry is prevalent. Also, these regulations and conditions could affect our ability to realize synergies from the acquisition, and could negatively affect both us and the Bank following the acquisition and could also delay or prevent the development, introduction and marketing of new products and services.

We may incur costs to avoid investment company status and our business would suffer significant harm if we were deemed to be an investment company

We may incur significant costs to avoid investment company status and may suffer other adverse consequences if we are deemed to be an investment company under the Investment Company Act of 1940, commonly referred to as the 1940 Act.

A company may be deemed to be an investment company if it owns investment securities with a value exceeding 40% of its total assets, subject to certain exclusions. As a result of the sale in May 2001 of $325 million principal amount of our convertible subordinated notes, we will have substantial short-term investments until the net proceeds from the sale can be deployed. In addition, we and our subsidiaries have made minority equity investments in other companies that may constitute investment securities under the 1940 Act. In particular, many of our publicly-traded equity investments, which are owned directly or indirectly by us or through related venture funds, are deemed to be investment securities. Although our investment securities currently comprise less than 40% of our total assets, the value of these minority investments has fluctuated in the past, and substantial appreciation in some of these investments or a decline in our total assets may, from time to time, cause the value of our investment securities to exceed 40% of our total assets. These factors may result in us being treated as an "investment company" under the 1940 Act.

We believe we are primarily engaged in a business other than investing, reinvesting, owning, holding, or trading securities for our account and, therefore, are not an investment company within the meaning of the 1940 Act. However, in the event that the 40% limit were to be exceeded (including through fluctuations in the value of our investment securities), we may need to reduce our investment securities as a percentage of our total assets. This reduction can be attempted in a number of ways, including the sale of investment securities and the acquisition of non-investment security assets, such as cash, cash equivalents and U.S. government securities. If we sell investment securities, we may sell them sooner than we intended. These sales may be at depressed prices and we may never realize anticipated benefits from, or may incur losses on, these investments. Some investments may not be sold due to normal contractual or legal restrictions or the inability to locate a suitable buyer. Moreover, we may incur tax liabilities if we sell these assets. We may also be unable to purchase additional investment securities that may be important to our operating strategy. If we decide to acquire non-investment security assets, we may not be able to identify and acquire suitable assets, and will likely realize a lower return on any such investments.

If we were deemed to be an investment company, we could become subject to substantial regulation under the 1940 Act with respect to our capital structure, management, operations, affiliate transactions and other matters. As a consequence, we could be barred from engaging in business or issuing our securities as we have in the past and might be subject to civil and criminal penalties for noncompliance. In addition, some of our contracts might be voidable, and a court-appointed receiver could take control of us and liquidate our business in certain circumstances.

RISKS RELATING TO OWNING OUR STOCK

Our historical quarterly results have fluctuated and do not reliably indicate future operating results

We do not believe that our historical operating results should be relied upon as an indication of our future operating results. We expect to experience large fluctuations in future quarterly operating results that may be caused by many factors, including the following:

- fluctuations in the fair market value of our equity investments in other companies, including through existing or future private investment funds managed by us,
- fluctuations in interest rates, which will impact our investment and loan portfolios,
- changes in trading volume in securities markets,
- the success of, or costs associated with, acquisitions, joint ventures or other strategic relationships,
- changes in key personnel,
- seasonal trends,
- purchases and sales of securities and other assets as part of the Bank's portfolio restructuring efforts,
- customer acquisition costs, which may be affected by competitive conditions in the marketplace,
- the timing of introductions or enhancements to online financial services and products by us or our competitors,
- market acceptance of online financial services and products,
- domestic and international regulation of the brokerage, banking and Internet industries,
- accounting for derivative instruments and hedging activities,
- changes in domestic or international tax rates,

- changes in pricing policies by us or our competitors,

- fluctuation in foreign exchange rates, and
- changes in the level of operating expenses to support projected growth.

We have also experienced fluctuations in the average number of customer transactions per day. Thus, the rate of growth in customer transactions at any given time is not necessarily indicative of future transaction activity.

We have incurred losses in the past and we cannot assure you that we will be profitable

We have a long history of incurring operating losses in each fiscal year and we may incur operating losses in the future. We incurred net losses of $402,000 in fiscal 1998, $56.8 million in fiscal 1999 and $243.7 million in the nine months ended September 30, 2001. Although we achieved profitability in fiscal 2000 due in part to sales of investment securities, we cannot assure you that profitability will be achieved in future periods.

The market price of our common stock may continue to be volatile which could cause litigation against us and the inability of shareowners to resell their shares at or above the prices at which they acquire them

From January 1, 2001 through September 30, 2001, the price per share of our common stock has ranged from a high of $15.38 to a low of $4.07. The market price of our common stock has been, and is likely to continue to be, highly volatile and subject to wide fluctuations due to various factors, many of which may be beyond our control, including:

- quarterly variations in operating results,
- volatility in the stock market,
- volatility in the general economy,
- changes in interest rates,
- announcements of acquisitions, technological innovations or new software, services or products by us or our competitors, and
- changes in financial estimates and recommendations by securities analysts.

In addition, there have been large fluctuations in the prices and trading volumes of securities of many technology, Internet and financial services companies. This volatility is often unrelated or disproportionate to the operating performance of these companies. Broad market and industry factors may decrease the market price of our common stock. In the past, volatility in the market price of a company's securities has often led to securities class action litigation. Such litigation could result in substantial costs to us and divert our attention and resources, which could harm our business. Declines in the market price of our common stock or failure of the market price to increase could also harm our ability to retain key associates, our access to capital and other aspects of our business, which also could harm our business.

We may need additional funds in the future which may not be available and which may result in dilution of the value of our common stock

In the future, we may need to raise additional funds for various purposes, including to expand our technology resources, to hire additional associates, to make acquisitions or to increase the Bank's total assets or deposit base. Additional financing may not be available on favorable terms, if at all. If adequate funds are not available on acceptable terms, we may be unable to fund our business growth plans. In addition, if funds are available, the result of our issuing securities could be to dilute the value of shares of our common stock and cause the market price to fall.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

For quantitative and qualitative disclosures about market risk, we have evaluated such risk for our domestic retail brokerage, banking, global and institutional, and asset gathering and other segments separately. The following discussion about our market risk disclosures includes forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of certain factors, including those set forth in the section entitled "Risk Factors" and elsewhere in this filing.

Domestic Retail Brokerage, Global and Institutional, and Asset Gathering and Other

Our domestic retail brokerage, global and institutional, and asset gathering and other operations are exposed to market risk related to changes in interest rates, foreign currency exchange rates and equity security price risk. However, we do not believe any such exposures are material. To reduce certain risks, we utilize derivative financial instruments; however, we do not hold derivative financial instruments for speculative or trading purposes.

Interest Rate Sensitivity

During the quarter ended September 30, 2001, we had a variable rate bank line of credit and three variable rate term loans. As of September 30, 2001, we had no borrowings outstanding under this line of credit and $14.7 million outstanding under these term loans. The line of credit and term loans and the monthly interest payments are subject to interest rate risk. If market interest rates were to increase immediately and uniformly by one percent at September 30, 2001, the interest payments would increase by an immaterial amount.

Foreign Currency Exchange Risk

A portion of our operations consist of brokerage and investment services outside of the United States. As a result, our results of operations could be adversely affected by factors such as changes in foreign currency exchange rates or economic conditions in the foreign markets in which we provide our services. We are primarily exposed to changes in exchange rates on the Japanese yen, the British pound, the Canadian dollar and the Euro. When the U.S. dollar strengthens against these currencies, the U.S. dollar value of non-U.S. dollar-based revenues decreases. When the U.S. dollar weakens against these currencies, the U.S. dollar value of non-U.S. dollar-based revenues increases. Correspondingly, the U.S. dollar value of non-U.S. dollar-based costs increases when the U.S. dollar weakens and decreases when the U.S. dollar strengthens. We are a net payer of British pounds and, as such, benefit from a stronger dollar, and are adversely affected by a weaker dollar relative to the British pound. However, we are a net receiver of currencies other than British pounds, and as such, benefit from a weaker dollar, and are harmed by a stronger dollar relative to these currencies. Accordingly, changes in exchange rates may adversely affect our consolidated sales and operating margins as expressed in U.S. dollars.

To mitigate the short-term effect of changes in currency exchange rates on our non-U.S. dollar-based revenues and operating expenses, we routinely hedge our material net non-U.S. dollar-based exposures by entering into foreign exchange forward and option contracts. Currently, hedges of transactions do not extend beyond twelve months and are immaterial. Given the short-term nature of our foreign exchange forward and option contracts, our exposure to risk associated with currency market movement on the instruments is not material.

Financial Instruments

For our working capital and reserves, which are required to be segregated under Federal or other regulations, we primarily invest in money market funds, resale agreements, certificates of deposit, and commercial paper. Money market funds do not have maturity dates and do not present a material market risk. The other financial instruments are fixed rate investments with short maturities and do not present a material interest rate risk.

Banking Operations

During the quarter, interest rates declined as a result of weaker economic fundamentals in the United States and the tragic events of September 11, 2001. Lower interest rates increased prepayments on mortgages as borrowers took advantage of the new levels for rates. The effect of the increased level of mortgage prepayments was predominantly offset by the Bank’s hedging strategies.

We employ various techniques to manage the variability of the fair value of equity by controlling the relative sensitivity of market value of interest-earning assets and interest-bearing liabilities. The sensitivity of changes in market value of assets and liabilities is affected by factors, including the level of interest rates, market expectations regarding future interest rates, projected related loan prepayments and the repricing characteristics of interest-bearing liabilities. We use hedging techniques including interest rate swaps and options to reduce the variability of fair value of equity and its overall interest rate risk exposure.

An asset or liability is said to be interest rate sensitive within a specific period if it will mature or reprice within that period or otherwise is subject to early prepayment. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within the same time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities and is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. Generally, during a period of rising interest rates, a negative gap would adversely affect net interest income, while a positive gap would result in an increase in net interest income.

The following assumptions were used to prepare our gap table at September 30, 2001. Non-amortizing investment securities are shown in the period in which they contractually mature. Investment securities that contain embedded options such as puts or calls are shown in the period in which that security is currently expected to be put or called or to mature. The table assumes that adjustable-rate residential mortgage loans and mortgage-backed securities prepay at an annual rate of between 17% and 75%, based on estimated future prepayment rates for comparable market benchmark securities and the Bank’s prepayment history. The table also assumes that fixed-rate, residential loans and mortgage-backed securities prepay, at an annual rate of between 12% and 72%. The above assumptions were applied on a pool-by-pool basis depending on the pools characteristics which include, but are not limited to, the following: product type, coupon rate, rate adjustment frequency, periodic cap, lifetime cap and net coupon reset margin. Time deposits are shown in the period in which they contractually mature, and savings deposits are shown to reprice within 14 months. The interest rate sensitivity of our assets and liabilities could vary substantially if different assumptions were used or if actual experience differs from the assumptions used.

The following table sets forth our gap at September 30, 2001 (dollars in thousands):

	Balance at September 30, 2001	Percent of Total	Repricing Within 0-3 Months	Repricing Within 4-12 Months	Repricing Within 1-5 Years	Repricing in More Than 5 Years
Interest-earning banking assets:						
Loans receivable, net	$ 6,301,880	49.95%	$ 632,556	$1,310,203	$3,132,769	$1,226,352
Mortgage-backed securities, available-for-sale and trading	4,164,937	33.01%	266,772	436,855	1,329,731	2,131,579
Investment securities, available-for-sale and FHLB stock	1,176,428	9.32%	235,206	176,344	501,351	263,527
Federal funds sold and interest-bearing deposits	974,065	7.72%	974,065	—	—	—
Total interest-earning banking assets	12,617,310	100.00%	$2,108,599	$1,923,402	$4,963,851	$3,621,458
Non-interest-earning banking assets	522,492					
Total banking assets	$13,139,802					

Interest-bearing banking liabilities:						
Savings deposits	$ 2,404,516	20.72%	$ —	$ —	$2,404,516	$ —
Time deposits	5,623,477	48.47%	1,450,328	2,959,771	1,206,805	6,573
FHLB advances	1,033,300	8.91%	933,300	—	50,000	50,000
Other borrowings	2,540,868	21.90%	2,540,868	—	—	—
Total interest-bearing banking liabilities	11,602,161	100.00%	$4,924,496	$2,959,771	$3,661,321	$ 56,573
Non-interest-bearing banking liabilities	742,596					
Total banking liabilities	$12,344,757					
Periodic gap			$(2,815,897)	$(1,036,369)	$1,302,530	$3,564,885
Cumulative gap			$(2,815,897)	$(3,852,266)	$(2,549,736)	$1,015,149
Cumulative gap to total assets			(21.4)%	(29.3)%	(19.4)%	7.7%
Cumulative gap to total assets hedge affected			24.7%	29.4%	(16.5)%	7.7%
As of June 30, 2001:						
Cumulative gap to total assets			(31.9)%	(47.5)%	(22.8)%	5.9%
Cumulative gap to total assets hedge affected			8.2%	7.0%	(18.2)%	5.9%
As of September 30, 2000:						
Cumulative gap to total assets			(36.9)%	(49.1)%	(24.0)%	6.5%
Cumulative gap to total assets hedge affected			1.1%	(12.8)%	(21.5)%	6.5%

As of September 30, 2001, the Bank's cumulative one-year gap and five-year gap to total assets hedge affected of positive 29.4% and negative 16.5% have decreased from positive 7.0% and negative 18.2% as of June 30, 2001. The changes are due largely to additional hedging activity and the shortening of duration of the mortgage assets as a result of lower interest rates and faster prepayment assumptions.

PART II. OTHER INFORMATION

Item 1. Legal and Administrative Proceedings

In the ordinary course of our business, we engaged in certain stock loan transactions with MJK Clearing, Inc., referred to in this Form 10-Q as MJK, involving the lending of Nasdaq-listed common stock of GenesisIntermedia, Inc. referred to in this Form 10-Q as GENI and other securities from MJK to us. Subsequently, we relent the GENI securities received from MJK to three other broker dealers, Wedbush Morgan Securities, referred to in this Form 10-Q as Wedbush, Nomura Securities, Inc., referred to in this Form 10-Q as Nomura, and Fiserv Securities, Inc., referred to in this Form 10-Q as Fiserv. On September 25, 2001, Nasdaq halted trading in the stock of GENI, which had last traded at a price of $5.90 before the halt. As a result, MJK was unable to meet its collateral requirements on the GENI and other securities with certain counterparties to those transactions. MJK was ordered to cease operations by the SEC because they failed to meet regulatory capital requirements, and was placed into SIPC liquidation in the District of Minnesota. These events have led to disputes among several of the participants in the stock loan transactions involving the stock of GENI and other securities lent by MJK regarding which entities should bear the losses resulting from MJK's insolvency. We have worked with the participants and regulatory agencies to resolve these disputes, but to date the disputes have not been resolved. We are confident that E*TRADE Securities has sufficient capital in excess of regulatory requirements to cover any potential exposure arising from these matters. Wedbush, Nomura, and Fiserv have commenced separate legal actions against us. On or about October 1, 2001, Wedbush filed an action in the Superior Court of the State of California, Los Angeles County, Case No. BC258931. On or about October 21, 2001, Nomura filed an action against us in the United States District Court for the Southern District of New York, Case No. 01-CV-9270 (AGS). In addition, on or about October 4, 2001, Fiserv filed an action against us in the United States District Court for the Eastern District of Pennsylvania, Case No. CTV-01-5045. These actions seek various forms of equitable relief and seek repayment of a total of approximately $60.0 million dollars received by us in connection with the GENI stock loan transactions. We believe that the plaintiffs must look to MJK as the debtor for repayment, and that we have defenses in each of these actions and will vigorously defend ourselves in all matters. To date, we have successfully defeated all actions for interim relief or have entered into consent orders essentially maintaining the status quo between the parties until the matter can be judicially resolved. Because the litigation is in its early stages, we are unable to predict the ultimate outcome or the amount of any potential losses.

Reference is made to the information reported in prior filings with the Securities and Exchange Commission under Item 3. Legal and Administrative Proceedings in our Annual Report on Form 10-K, as amended, for the year ended September 30, 2000, and under Part II Item 1. Legal and Administrative Proceedings in our Transition Report on Form 10-QT for the quarter ended December 31, 2000, our Report on Form 10-Q for the quarter ended March 31, 2001 and our report on Form 10-Q for the quarter ended June 30, 2001.

From time to time, we have been threatened with, or named as a defendant in, lawsuits, arbitrations and administrative claims involving both securities related and non-securities related matters. We are also subject to periodic regulatory audits and inspections. Compliance and trading problems that are reported to regulators such as the SEC or the NASDR by dissatisfied customers or others are investigated by such regulators, and may, if pursued, result in formal arbitration claims being filed against us by customers and/or disciplinary action being taken against us by regulators. Any such claims or disciplinary actions that are decided against us could harm our business. The securities industry is subject to extensive regulation under federal, state and applicable international laws. As a result, we are required to comply with many complex laws and rules and our ability to so comply is dependent in large part upon the establishment and maintenance of a qualified compliance system.

We maintain insurance in such amounts and with such coverages, deductibles and policy limits as management believes are reasonable and prudent. The principal risks that we insure against are comprehensive general liability, commercial property damage, hardware and software damage, directors and officers, fidelity (crime) bond, and errors and omissions liability. We believe that such insurance coverage is adequate for the purpose of our business.

Item 2. Changes in Securities and Use of Proceeds

On July 15, 2001, the Company authorized the issuance of an aggregate of 1,407,499 shares of unregistered common stock in connection with the acquisition of E*TRADE Germany AG (renamed E*TRADE Bank AG on May 17, 2001). No underwriters were involved, and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

On July 23, 2001, the Company authorized the issuance of an aggregate of 556,757 shares of unregistered common stock in connection with the acquisition of Private Accounts, Inc. (renamed E*TRADE Advisory Services Inc. on January 2, 2001). In addition, 139,557 shares were released from escrow pursuant to the terms of the merger agreement. The shares were issued pursuant to the terms of the merger agreement as a portion of the consideration for the merger. No underwriters were involved, and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

In August 2001, holders of aggregate principal amount of $40,000,000 of our 6% convertible notes agreed to exchange such notes for an aggregate of 4,185,000 shares of common stock in exchanges exempt from registration pursuant to Section 3(a)(9) of the Securities Act of 1933.

In September 2001, holders of an aggregate principal amount of $20,000,000 of our 6% convertible notes agreed to exchange such notes for an aggregate of 2,100,000 shares of common stock in exchanges exempt from registration pursuant to Section 3(a)(9) of the Securities Act.

On October 1, 2001, the Company authorized the issuance of an aggregate of 254,272 additional shares of unregistered common stock in connection with the acquisition of Electronic Investing Corporation. No underwriters were involved, and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

On October 1, 2001, the Company issued 28,929,498 shares of its common stock in connection with the acquisition of Dempsey, which together with cash in the amount of $20.0 million constituted the consideration for all of the issued and outstanding capital stock of Dempsey. No underwriters were involved, and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

Item 3. Defaults Upon Senior Securities—Not applicable

Item 4. Submission of Matters to a Vote of Security Holders—None

Item 5. Other Information—None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit Number	
2.1	Agreement and Plan of Mergers, Member Interest Purchase and Reorganization, dated as of August 29, 2001, by and among the Company, Dempsey LLC and the individuals and entities named therein (incorporated by reference to Exhibit 99.1 of the Company's Current Report on Form 8-K filed on September 19, 2001).
*10.1	Termination Agreement and General Release by and between the Company and SoundView Technology Group, Inc. dated August 20, 2001.
*10.2	Agreement regarding Increase of Capital Commitment of the Company and Modification of Order of Fund Distribution by and between the Company and ArrowPath Venture Partners I, LLC dated October 1, 2001.
*10.3	Amendment to Amended and Restated Limited Partnership Agreement of E*TRADE eCommerce Fund L.P.
*10.4	Form of Note and Stock Pledge Agreement by and between the Company and William Porter dated September 17, 2001.
*10.5	Second Amended Employment Agreement dated August 27, 2001, by and between the Company and Christos M. Cotsakos.

* Filed herewith.

(b) Reports on Form 8-K

On July 10, 2001, the Company filed a Current Report on Form 8-K to report the adoption of its stockholder rights plan.

On July 24, 2001, the Company filed a Current Report on Form 8-K to report the announcement of its financial results for the quarter ended June 30, 2001.

On September 19, 2001, the Company filed a Current Report on Form 8-K to report that it had signed an Agreement and Plan of Mergers in connection with the Company's acquisition of Dempsey & Company LLC and to report a plan to consolidate facilities, which consolidation led to a nonrecurring charge for the quarter ended September 30, 2001.

On October 15, 2001, the Company filed a Current Report on Form 8-K to report that it had consummated its previously announced acquisition of Dempsey & Company LLC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

E*TRADE Group, Inc.
(Registrant)

Dated: November 6, 2001

/s/ CHRISTOS M. COTSAKOS
By ______________________________

Christos M. Cotsakos
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

/s/ LEONARD C. PURKIS
By ______________________________

Leonard C. Purkis
Chief Finance and Administration Officer
(Principal Financial and Accounting Officer)

Exhibit 10.1

TERMINATION AGREEMENT AND GENERAL RELEASE

This TERMINATION AGREEMENT AND GENERAL RELEASE (hereinafter, the **"Termination Agreement"**) is hereby entered into as of the 20th day of August 2001, by and between SoundView Technology Group, Inc., a Delaware corporation formerly known as Wit SoundView Group, Inc. and as Wit Capital Group, Inc. (**"Wit SoundView"**), and E*TRADE Group Inc., a Delaware corporation (**"E*TRADE"**). Wit SoundView and E*TRADE are referred to herein as the **"Parties,"** and each of them individually as a **"Party."**

RECITALS

WHEREAS, Wit SoundView and E*TRADE are Parties to that certain Amended and Restated Strategic Alliance Agreement, dated as of September 26, 2000 (the **"Strategic Alliance Agreement"**);

WHEREAS, Wit SoundView, Wit SoundView Corporation, a Delaware corporation, and E*OFFERING Corp., a California corporation (**"E*OFFERING"**) are parties to that certain Agreement and Plan of Merger dated as of May 15, 2000 (the **"Merger Agreement"**);

WHEREAS, pursuant to Section 4.2(b) of the Merger Agreement, E*OFFERING obtained the consent of certain of its shareholders, including E*TRADE, to certain restrictions on the common stock received by such shareholders pursuant to the Merger Agreement, which restrictions include the deposit of a portion of such shares in a **"Special Escrow Fund"** (as defined in the Merger Agreement) for a period of three (3) years;

WHEREAS, Wit SoundView, Wit Capital Corporation, a Delaware corporation (**"Wit Capital Corporation"**), and E*TRADE are parties to that certain Account Transfer Agreement, dated as of May 15, 2000 (the **"Account Transfer Agreement")**;

WHEREAS, Wit SoundView, E*TRADE and certain entities affiliated with General Atlantic Partners, LLC are parties to that certain Stock Purchase Agreement dated as of May 15, 2000 (the **"Stock Purchase Agreement")**;

WHEREAS, Wit SoundView and E*TRADE are parties to that certain Standstill Agreement, dated as of May 15, 2000 (the **"Standstill Agreement")**;

WHEREAS, the Parties seek to (i) terminate certain of the obligations and rights arising under the Strategic Alliance Agreement and (ii) enter into a new agreement that will describe the relationship between the Parties going forward (**"the Relationship Agreement")**;

WHEREAS, simultaneously herewith, E*TRADE seeks to transfer to Wit SoundView certain warrants to purchase shares and shares of common stock, par value $0.01 per share (the **"Common Stock"**) of Wit SoundView;

NOW, THEREFORE, in consideration of the covenants and agreements contained herein, and for other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the Parties hereto agree as follows:

AGREEMENT

1. *Stock Transfer and Warrants Cancellation*. In consideration of the obligations and transactions set forth herein, E*TRADE agrees to transfer to Wit SoundView, and Wit SoundView agrees to acquire from E*TRADE, (i) nine million three hundred forty nine thousand seven hundred sixty four (9,349,764) shares of Common Stock (the **"Shares"**) and (ii) those certain warrants entitling E*TRADE to purchase (a) one million eight hundred twenty one thousand nine hundred thirty six (1,821,936) shares of Common Stock at a price of $0.60 per share and (b) two million (2,000,000) shares of Common Stock at a price of $10.25 per share (collectively the **"Warrants"**); *provided, however,* that E*TRADE shall be permitted in its sole and absolute discretion to determine which of its shares of Common Stock shall be transferred to Wit SoundView pursuant to this Termination Agreement. The Shares and the Warrants shall be duly endorsed or accompanied by stock powers duly endorsed in blank.

2. *Termination of Agreements*.

(a) Wit SoundView and E*TRADE agree and acknowledge that, upon execution and delivery of this Termination Agreement and the delivery of the Shares and Warrants to Wit Sound View, the Strategic Alliance Agreement is hereby terminated in its entirety and shall be of no further force or effect and neither of the Parties shall have any obligation to the other Party under the Strategic Alliance Agreement.

(b) Wit SoundView and E*TRADE agree and acknowledge that, except as specifically provided in this Termination Agreement, nothing in this Termination Agreement shall terminate or otherwise affect the rights and obligations of the respective parties to the Merger Agreement, the Account Transfer Agreement, the Stock Purchase Agreement and the Standstill Agreement.

3. *Future Relationship of the Parties.* The Parties shall enter into a new business relationship as set forth in the Relationship Agreement attached as Exhibit 1 to this Termination Agreement, which Relationship Agreement shall be executed simultaneously with the execution of this Termination Agreement.

4. *Removal of Transfer Restrictions.*

(a) Wit SoundView and E*TRADE agree and acknowledge that simultaneously with the execution of this Termination Agreement, Wit SoundView shall take reasonable commercial steps to cause the shares of Wit SoundView common stock issued to E*TRADE and certain other shareholders pursuant to the Merger Agreement that are held in the Special Escrow Fund to be released from the Special Escrow Fund; *provided*, *however*, that nothing in this Termination Agreement shall terminate or otherwise affect the rights and obligations of the parties to the Merger Agreement.

(b) Wit SoundView agrees to cause all remaining restrictions on the transfer of shares of Common Stock beneficially owned by E*TRADE (whether from the Strategic Alliance Agreement or the Merger Agreement) to be removed, except for those restrictions based on federal and state securities laws; *provided*, *however*, that nothing in this Termination Agreement shall terminate or otherwise affect the rights and obligations of the parties to the Merger Agreement.

(c) In order to effect the removal of the restrictions on transfer of the shares as described in this Section 4, the holders of these shares shall present their shares to Wit SoundView, and Wit SoundView shall direct its transfer agent to promptly return to the holders certificates representing such shares bearing only the following legend: "The shares represented hereby have not been registered under the Securities Act of 1933, as amended, and may not be sold, transferred, assigned, pledged, or hypothecated unless and until registered under such Act, or unless the company has received an opinion of counsel or other evidence satisfactory to the company and its counsel, that such registration is not required." All other restrictive legends shall be removed from the revised certificates. In addition, Wit SoundView shall promptly notify the transfer agent that the shares are subject only to the foregoing restrictions.

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5. *Registration Rights*. Wit SoundView agrees to take reasonable commercial steps to register the shares of Common Stock beneficially owned by E*TRADE following the transfers described in Section 1 above as provided in, and subject to the terms of, the Registration Rights Agreement dated as of October 16, 2000 between the Parties and certain other shareholders.

6. *Hiring of Employees and Consultants*. E*TRADE shall not be prohibited in any manner from hiring as an employee or consultant any employee or consultant of Wit SoundView. Wit SoundView shall not be prohibited in any manner from hiring as an employee or consultant any employee or consultant of E*TRADE.

7. *Marketing Materials*. Wit SoundView and E*TRADE shall promptly take commercially reasonable steps to remove all references to any activities with the other formerly conducted pursuant to the Strategic Alliance Agreement in their marketing materials and brochures. From and after the date hereof, E*TRADE and its affiliates agree not to refer in any Marketing Materials to Wit SoundView without the prior written consent of Wit SoundView, and Wit SoundView agrees not to refer in any Marketing Materials to E*TRADE or any of its affiliates without the prior written consent of E*TRADE or any of its affiliates, in each case, such consent not to be unreasonably withheld or delayed.

8. *Research Products Prepared by Wit SoundView*. E*TRADE may continue to provide research products developed by Wit SoundView for the benefit and use by the retail customers of E*TRADE on a non-exclusive basis on terms and conditions to be mutually agreed by the Parties.

9. *Confidentiality*.

(a) *Confidential Information*. For purposes of this Termination Agreement, **"Confidential Information"** of a Party means any information disclosed by that Party to another Party pursuant to the Strategic Alliance Agreement, and which the disclosing Party has not specifically identified in writing as non–confidential to the receiving Party, including, but not limited to, that which relates to patents, patent applications, research, product plans, products, developments, inventions, processes, designs, drawings; engineering, formulae, markets, software (including source and object code), hardware configuration, computer programs, algorithms, regulatory information, medical reports, clinical data and analysis, business plans, agreements with third parties, services, customers, marketing or finances of the disclosing Party.

(b) *Return of Confidential Information*. Promptly following execution and delivery of this Termination Agreement, except as may be necessary to retain in connection with the Parties' obligations and responsibilities pursuant to the Relationship Agreement or under applicable law, (a) E*TRADE shall return to Wit SoundView (or, at the request of Wit SoundView, destroy) any and all Confidential Information of Wit SoundView which is in the possession or control of E*TRADE, and (b) Wit SoundView shall return to E*TRADE (or, at the request of E*TRADE, destroy) any and all Confidential Information of E*TRADE which is in the possession or control of Wit SoundView.

(c) *Nondisclosure*. Notwithstanding the return of Confidential Information pursuant to Section 9(b) above, the termination of the Strategic Alliance Agreement pursuant to Section 2 or any of the other provisions of this Termination Agreement, each of the Parties shall continue to treat as confidential all Confidential Information of the other Party, shall not use such Confidential Information for any purpose whatsoever, and shall use reasonable efforts not to disclose such Confidential Information to any third party. Without limiting the foregoing, each of the Parties shall use at least the same degree of care which it uses to prevent the disclosure of its own confidential information of like importance to prevent the disclosure of Confidential Information disclosed to it by the other Party under any of the relevant agreements. Each Party shall promptly notify the applicable Party of any actual or suspected misuse or unauthorized disclosure of such other Party's Confidential Information.

(d) *Exceptions*. Notwithstanding the above, no Party shall have liability to the other Party with regard to any Confidential Information of the other which the receiving Party can prove: (i) was in the public domain at the time it was disclosed or has entered the public domain through no fault of the receiving Party; (ii) was known to the receiving Party, without restriction, at the time of disclosure, as demonstrated by files in existence at the time of disclosure; (iii) is disclosed with the prior written approval of the other Party; (iv) was independently developed by the receiving Party without any use of the Confidential Information, as demonstrated by files created at the time of such independent development; (v) becomes known to the receiving Party, without restriction, from a source other than the other Party without breach of this Termination Agreement by the receiving Party and otherwise not in violation of the other Party's rights; or (vi) is disclosed pursuant to the order or requirement of a court, administrative agency, or other governmental body; *provided, however*, that the receiving Party shall provide prompt notice thereof to the other Party to enable the other Party to seek a protective order or otherwise prevent or restrict such disclosure.

(e) *Remedies*. Any breach of the restrictions contained in this Section 9 may cause irreparable harm to the non-breaching Parties. Any such breach shall entitle the nonbreaching Parties to injunctive relief in addition to all legal remedies.

For purposes of this Section 9, the term "Party" shall include all controlled affiliates of such Party.

10. *Representations and Warranties of E*TRADE.* E*TRADE represents and warrants to Wit SoundView as of the date hereof that:

(a) *Corporation Existence and Power.* E*TRADE is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware and has all corporate powers and all governmental licenses, authorizations, permits, consents and approvals required to carry on its business as now conducted, and to enter into and perform its obligations under this Termination Agreement, except for those licenses, authorizations, permits, consents and approvals the absence of which would not have a material adverse effect on its ability to carry out the transactions contemplated herein.

(b) *Corporate Authorization*. The execution, delivery and performance by E*TRADE of this Termination Agreement and the consummation of the transactions contemplated hereby, including the release of claims herewith, is within E*TRADE's corporate powers and has been duly authorized by all necessary corporate action on the part of E*TRADE. This Termination Agreement constitutes a valid and binding agreement of E*TRADE enforceable in accordance with its terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights and remedies generally.

(c) *Ownership of the Shares and the Warrants*. E*TRADE is the record and beneficial owner of the Shares and the Warrants, free and clear of any lien, security interest or other encumbrance, and will transfer and deliver to Wit SoundView good and valid title to the Shares and the Warrants free and clear of any lien, security interest or other encumbrance. E*TRADE has not granted any option or other right to acquire the Shares, the Warrants or any shares of Common Stock underlying the Warrants. E*TRADE irrevocably and permanently waives any and all preemptive rights, rights of first refusal or other similar rights to acquire any equity security of Wit SoundView or participate in any financing of Wit SoundView.

(d) *Non-Contravention*. The execution and delivery by E*TRADE of this Termination Agreement, the consummation of the transactions contemplated hereby and thereby, and compliance by E*TRADE with any of the provisions hereof and thereof will not conflict with, constitute a default under or violate (x) any of the terms, conditions or provisions of the certificate of incorporation or by-laws of E*TRADE, (y) any of the terms, conditions or provisions of any document, agreement or other instrument to which E*TRADE is a party or by which its property is bound, or (z) any judgment, writ, injunction, decree, order or ruling of any court or governmental authority binding on E*TRADE or its property.

(e) *Information*. E*TRADE has not sought, and wishes not to obtain, any other information from or about Wit SoundView other than the representations and warranties set forth in Section 11.

11. *Representations and Warranties of Wit SoundView*. Wit SoundView represents and warrants to E*TRADE as of the date hereof that:

(a) *Corporation Existence and Power*. Wit SoundView is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware and has all corporate powers and all material governmental licenses, authorizations, permits, consents and approvals required to carry on its business as now conducted and to enter into and perform its obligations under this Termination Agreement, except for those licenses, authorizations, permits, consents and approvals the absence of which would not have a material adverse effect on its ability to carry out the transactions contemplated herein.

(b) *Corporation Authorization.* The execution, delivery and performance by E*TRADE of this Termination Agreement and the consummation of the transactions contemplated hereby, including the release of claims herewith, is within the corporate powers of Wit SoundView and have been duly authorized by all necessary corporate action on the part of Wit SoundView. This Termination Agreement constitutes a valid and binding agreement of Wit SoundView, enforceable in accordance with its terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights and remedies generally.

(c) *Non-Contravention*. The execution and delivery by Wit SoundView of this Termination Agreement and the consummation of the transactions contemplated hereby, and compliance by Wit SoundView with any of the provisions hereof will not conflict with, constitute a default under or violate (x) any of the terms, conditions or provisions of its certificate of incorporation or by-laws, (y) any of the terms, conditions or provisions of any document, agreement or other instrument to which Wit SoundView is a party or by which its property is bound, or (z) any judgment, writ, injunction, decree, order or ruling of any court or governmental authority binding on it or its property.

(d) *Information*. Wit SoundView has not sought, and wishes not to obtain, any other information from or about E*TRADE other than the representations and warranties set forth in Section 10.

12. *Reliance on Independent Legal Advice*. Each of the Parties further represent and warrant to each other, as of the date hereof:

(a) That it has received advice from its own, independent legal counsel prior to its execution of this Termination Agreement;

(b) That the legal nature and effect of this Termination Agreement has been explained to it by its counsel;

(c) That it fully understands the terms and provisions of this Termination Agreement and the nature and effect thereof;

(d) That it has not relied and is not relying upon any representation or statement of any person not contained in this Termination Agreement or on the advice of any counsel other than its own counsel;

(e) That it has carefully read this Termination Agreement, knows the contents hereof, and is executing the same freely and voluntarily; and

(f) That it is aware that it or its attorneys may hereafter discover facts different from or in addition to the facts that it now knows or believes to be true with respect to the subject matter of this Termination Agreement or the other Party hereto, but that it is its intention to fully and finally release each of its respective releasees to the full extent of the releases contained in this Termination Agreement, and to otherwise agree to the other terms and conditions of this Termination Agreement.

13. *Waiver of Civil Code Section 1542*. Each Party represents, warrants, and agrees that it has been informed of, has read, is familiar with, understands, and does hereby expressly waive all rights that it has or may have under Section 1542 of the California Civil Code and all other similar rights in other states or territories of the United States of America, or any other jurisdiction, as said Section may apply to the releases in this Termination Agreement only. Said Section 1542 provides:

> A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM, MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR

14. *Global Release of All Claims Against E*TRADE by Wit SoundView*. Effective as of the date hereof, Wit SoundView, for itself, and for any parent, subsidiary or affiliate corporation, partnership, limited liability company, proprietorship, trust, or other form of business entity related directly or indirectly to any of the foregoing, and for each of their respective heirs, administrators, executors, beneficiaries, legatees, devisees, trusts, trustees, insurers, attorneys, experts, consultants, partners, joint venturers, members, officers, directors, shareholders, employees, contractors, alter egos, agents, representatives, predecessors, successors and assigns (collectively the **"Wit SoundView Releasors"**), does hereby release, acquit, and forever discharge E*TRADE and any parent, subsidiary or affiliate corporation, partnership, limited liability company, proprietorship, trust, or other form of business entity related directly or indirectly to the foregoing, and each of their respective heirs, administrators, executors, beneficiaries, legatees, devisees, trusts, trustees, insurers, attorneys, experts, consultants, partners, joint venturers, members, officers, directors, shareholders, employees, contractors, alter egos, agents, representatives, predecessors, successors and assigns (collectively the **"E*TRADE Releasees"**) of and from any and all claims, actions, causes of action, judgments, awards, costs, expenses, attorneys' fees, debts, obligations, promises, representations, warranties, demands, acts, omissions, rights and liabilities, of any kind and nature whatsoever, including but not limited to those at law, in equity, in tort, in contract, whether or not asserted to date, and whether known or unknown, suspected or unsuspected, which have arisen, are arising, or may in the future arise, directly or indirectly, from or in connection with the Strategic Alliance Agreement, or any other matter or transaction of any kind or nature undertaken thereunder from the beginning of time until the date hereof (the matters referred to above being hereinafter referred to as the **"E*TRADE Released Claims"**); *provided, however*, that nothing in this Release shall release E*TRADE from any of its obligations under this Termination Agreement.

15. *Global Release of All Claims Against Wit SoundView by E*TRADE*. Effective as of the date hereof, E*TRADE, for itself, and for any parent, subsidiary or affiliate corporation, partnership, limited liability company, proprietorship, trust, or other form of business entity related directly or indirectly to any of the foregoing, and for each of their respective heirs, administrators, executors, beneficiaries, legatees, devisees, trusts, trustees, insurers, attorneys, experts, consultants, partners, joint venturers, members, officers, directors, shareholders, employees, contractors, alter egos, agents, representatives, predecessors, successors and assigns (collectively the **"E*TRADE Releasors"**), does hereby release, acquit, and forever discharge Wit SoundView, and any parent, subsidiary or affiliate corporation, partnership, limited liability company, proprietorship, trust, or other form of business entity related directly or indirectly to any of the foregoing, and each of their respective heirs, administrators, executors, beneficiaries, legatees, devisees, trusts, trustees, insurers, attorneys, experts, consultants, partners, joint venturers, members, officers, directors, shareholders, employees, contractors, alter egos, agents, representatives, predecessors, successors and assigns (collectively the **"Wit SoundView Releasees"**) of and from any and all claims, actions, causes of action, judgments, awards, costs, expenses, attorneys' fees, debts, obligations, promises, representations, warranties, demands, acts, omissions, rights and liabilities, of any kind and nature whatsoever, including but not limited to those at law, in equity, in tort, in contract, whether or not asserted to date, and whether known or unknown, suspected or unsuspected, which have arisen, are arising, or may in the future arise, directly or indirectly, from or in connection with the Strategic Alliance Agreement, or any other matter or transaction of any kind or nature undertaken thereunder from the beginning of time until the date hereof (the matters referred to above being hereinafter referred to as the **"Wit

SoundView Released Claims**"); *provided, however*, that nothing in this Release shall release Wit SoundView from any of its obligations under this Termination Agreement; and *provided further* that, notwithstanding any provision to the contrary in this Section 15, nothing in this Termination Agreement shall release Wit SoundView of its obligations to pay E*TRADE any outstanding balance for selling concessions based on transactions conducted pursuant to the Strategic Alliance Agreement.

16. *Covenant Not to Sue by Wit SoundView*. Except for the enforcement of this Termination Agreement or any rights preserved under this Termination Agreement, the Wit SoundView Releasors hereby covenant that they will not, based on any E*TRADE Released Claim, sue or bring any claim or action against any E*TRADE Releasee. This Covenant Not to Sue shall be a complete defense to any such claim or suit by any such Wit SoundView Releasor.

17. *Covenant Not to Sue by E*TRADE*. Except for the enforcement of this Termination Agreement or any rights preserved under this Termination Agreement, the E*TRADE Releasors hereby covenant that they will not, based on any Wit SoundView Released Claim, sue or bring any claim or action against any Wit SoundView Releasee. This Covenant Not to Sue shall be a complete defense to any such claim or suit by any such E*TRADE Releasor.

18. *Governing Law*. This Termination Agreement shall be governed by the laws of the State of New York as such laws are applied to agreements between New York residents entered into and to be performed entirely within the State of New York.

19. *No Admission of Fault*. This Termination Agreement is a compromise settlement of disputed claims and may not be deemed or used as an admission of liability or fault on the part of any Party hereto.

20. *Joint Drafting*. This Termination Agreement shall be construed as jointly drafted by the Parties, and the rule construing ambiguities against the drafter shall not apply.

21. *Integration Clause*. As of the date hereof, this Termination Agreement and any further documents executed to implement the transactions contemplated hereby, shall constitute the full and entire understanding and agreement between the Parties with respect to the subject matter hereof and shall supersede all prior conversations, negotiations, understandings and agreements between the Parties with respect to the subject matter hereof.

22. *Further Assurances*. From time to time after the date hereof, the Parties shall take such other actions and execute and deliver to any other Party such further documents as may be reasonably requested by any other Party in order to assure and confirm unto such Party (a) the rights created hereby or intended now or hereafter so to be created by this Termination Agreement; or (b) the validity of any assignment documents or other documents of conveyance to be delivered at the execution of this Termination Agreement.

23. *Arbitration.* All disputes and controversies of every kind and nature between the parties hereto arising out of or in connection with this Termination Agreement as to the construction, validity, interpretation or meaning, performance, non-performance, enforcement, operation or breach shall be submitted to arbitration in accordance with the provisions of the NASD Code of Arbitration Procedures.

24. *Each Party to Bear Own Costs and Attorneys' Fees*. Each Party shall bear its own costs, expenses, and attorneys' fees in connection with the negotiation, preparation, execution and delivery of this Termination Agreement and the transactions contemplated herein.

25. *Amendment Only in Writing*. This Termination Agreement may be modified only by a written agreement executed by the Parties affected by the modification.

26. *Severability*. The Parties hereto agree that if any provision of this Termination Agreement is held by a court of competent jurisdiction to be

invalid, void, or unenforceable, such provision shall be valid and enforceable to the maximum degree permitted and the remaining provisions shall nevertheless continue in full force without being impaired or invalidated in any way.

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27. *Survival*. The covenants, agreements, representations and warranties contained in this Termination Agreement shall be continuing and shall survive the execution and delivery of this Termination Agreement.

28. *Legal Proceedings*. Each Party represents, warrants, and agrees that no legal proceeding or other action has been filed in any forum arising out of, from, or in connection with any disputes or claims arising out of or related to the Agreements.

29. *No Assignment of Claims*. Each Party represents and warrants to the other that it has not hypothecated or otherwise encumbered or assigned any claim or cause of action arising out of, related to or in connection with the claims alleged in or referred to this Termination Agreement.

30. *Public Announcements*. The Parties will cooperate in developing a public announcement of the matters described herein; each Party hereby agrees not to release to the public any information relating to the matters described herein without the prior approval of the other Party; *provided, however,* that nothing herein shall limit either Party's right to make such disclosure as it reasonably believes is necessary to comply with disclosure obligations under applicable law or listing agreements.

31. *Counterparts*. This Termination Agreement may be executed in counterparts, each of which shall be deemed a duplicate original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed on their behalf as of the date first written above.

SOUNDVIEW TECHNOLOGY GROUP, INC.

/S/ MARK E. LOEHR

By: Mark E. Loehr

Title: Chief Executive Officer

E*TRADE GROUP, INC.

/S/ R. JARRETT LILIEN

By: R. Jarrett Lilien

Title: Chief Brokerage Officer

Exhibit 10.2

Agreement Regardng Increase of Capital Commitment
of
E*TRADE Group, Inc.
and
Modification of Order of Fund Distributions

This Agreement is entered as of the 1st day of October, 2001, by ArrowPath Venture Partners I, LLC, a Delaware limited liability company, as General Partner of E*TRADE eCommerce Fund, L.P., a Delaware limited partnership (the "Partnership"), and E*TRADE Group,Inc., a Delaware corporation ("E*TRADE"). (Terms not defined herein shall have the meaning ascribed to them in the Amended and Restated Limited Partnership Agreement of the Partnership dated October 8,1999 (the "Partnership Agreement").)

RECITALS

A. Upon the formation of the Partnership, E*TRADE contributed to the Partnership securities (the "Contributed Securities") consisting of stock of the following four (4) entities: PlanetRx.com, Inc., WebVan Group, Inc., Equinix, Inc. and LoanCity.com.

B. Based upon discussion with the other Limited Partners and in order to garner further goodwill from them, E*TRADE desires to enter into this Agreement.

C. E*TRADE is willing to increase its Capital Commitment to the Partnership by $7.5 million.

D. In addition, E*TRADE is agreeable to a modification of the order of any distributions from, and allocations of income of, the Partnership with respect to its initial Capital Contribution of the Contributed Securities and the Capital Contributions of the other Limited Partners on the terms referred to herein.

NOW, THEREFORE, the parties hereby agree as follows:

1. E*TRADE hereby agrees to increase its Capital Commitment to the Partnership by $7.5 million and shall make aggregate additional Capital Contributions to the Partnership in cash in an amount equal to its increased Capital Commitment. Such Capital Contributions shall be drawn down in accordance with the Partnership Agreement, as amended pursuant to the proposed Amendment to the Amended and Restated Limited Partnership Agreement of E*TRADE eCommerce Fund, L.P. attached hereto (the "Amendment"). E*TRADE agrees that there shall be no revaluation of the Partnership's assets in connection with E*TRADE's increased Capital Commitment and Capital Contributions.

2. E*TRADE further agrees to the terms of the proposed Amendment, a copy of which is attached hereto, which modifies E*TRADe's rights to distributions and

allocations of income with respect to its initial Capital Contribution of the Contributed Securities.

3. E*TRADE agrees that this Agreement shall be effective as of the date on which the General Partner certifies that Two-Thirds in Interest of the Limited Partners have consented to the Amendment (the "Effective Date"). E*TRADE hereby consents to the Amendment.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

ArrowPath Venture Partners I, LLC

By /s/ Thomas A. Berilacqua
Title Manager Member

E*TRADE Group, Inc.

By /s/ Leonard C. Purkis
Title Chief Finance and Administration Officer

Exhibit 10.3

Amendment
to
Amended and Restated Limited Partnership Agreement
of
E*TRADE eCommerce Fund, L.P.

This Amended and Restated Limited Partnership Agreement dated October 8, 1999 (the "Agreement") of E*TRADE eCommerce Fund, L.P., a Delaware limited partnership (the "Partnership"), is amended as follows (terms not otherwise defined herein shall have the meaning ascribed to them in the Agreement);

1. Article III of the Agreement is amended by adding the following Paragraph 3.6 at the end thereof.

"3.6. Additional Capital Commitment of E*TRADE. Notwithstanding the foregoing provisions of this Article III, E*TRADE's Capital Commitment to the Partnership shall be increased by $7.5 million (and its Partnership Percentage increased accordingly) as of the effective date of this Amendment, E*TRADE shall make aggregate additional Capital Contributions to the Partnership in cash equal to its $7.5 million increased Capital Commitment. Such Capital Contributions shall be drawn down in accordance with the procedures applicable to the other Limited Partners under Paragraph 3.2(a) of the Agreement. Upon the first Drawdown(s) after the date of this Amendment, E*TRADE shall be required to make Capital Contributions, prior to Capital Contributions by any other Limited Partner, in an amount such that the percentage of E*TRADE additional Capital Commitment satisfied by its additional Capital Contributions is the same as the percentage of the other Limited Partners' Capital Commitments satisfied by Capital Contributions. All subsequent Drawdowns from the respective Limited Partners shall be based on their relative remaining Capital Commitments. There will be no revaluation of the Partnership's assets in connection with E*Trade's additional Capital Commitment and Capital Contributions."

2. Paragraph 4.6 of the Agreement is amended and restated to read in its entirety as follows:

"4.6. Allocation Among Partners as a Group.

"(a) Except as otherwise specifically provided in this Agreement, all Capital Transaction Gain or Loss and Net Income and Loss (and items thereof) allocated to the Partners (or a group of Partners) as a group for any period shall be allocated among such Partners in proportion to their respective Partnership Percentages as of the end of such period. In making such allocations, any changes

in Partnership Percentages as a result of changes in the Capital Commitments of the Partners, any exclusion of any Partners from particular investments, any contributions of Partners to fund any Shortfall Amount and similar matters shall be taken into account.

"(b) Notwithstanding subparagraph (a), items of Net Income or Loss and Capital Transaction Gain or Loss allocable to the Limited Partners for a Fiscal Year or Interim Period shall be allocated among them in a manner such that:

"(1) a Limited Partner is allocated items of income and gain equal to any excess of (A) the Limited Partner's Target Capital Account as of the end of the period plus any distributions made to the Limited Partner during the period, over (B) the Limited Partner's Capital Account as of the beginning of the period plus any Capital Contributions made by the Limited Partner during the period; and

"(2) a Limited Partner is allocated items of loss and expense equal to any excess of (A) the Limited Partner's Capital Account as of the beginning of the period plus any Capital Contributions made by the Limited Partner during the period, over (B) the Limited Partner's Target Capital Account as of the end of the period plus any distributions made to the Limited Partner during the period.

"For this purpose, a Limited Partner's Target Capital Account as of the end of a Fiscal Year or Interim Period shall be equal to the amount of distributions to which the Limited Partner would be entitled if the Partnership were liquidated, its assets sold for their Book Value and the resulting assets, after payment of all Partnership obligations, were distributed in the manner prescribed in Paragraph 6.4 (without regard to Article VIII) on the last day of such period."

3. Paragraph 6.4 of the Agreement is amended by adding the following subparagraph (i) at the end thereof:

"(i) Notwithstanding anything to the contrary in the foregoing provisions of this Paragraph 6.4 (other than subparagraph (d)), all distributions to a Limited Partner who contributed Securities to the Partnership ("Securities-Contributing Limited Partner"), with respect to its initial Capital Contribution of Securities, and to the other Limited Partners ("Cash-Contributing Limited Partners") shall first be made in the following manner (instead of being made in proportion to their respective Partnership Percentages):

"(1) First to the Cash-Contributing Limited Partners until they have obtained a fifteen percent (15%) annual internal rate of return with respect to their Capital Contributions.

"(2) Then to the Securities-Contributing Limited Partner until it has obtained a fifteen percent (15%) annual internal rate of return with respect to its initial Capital Contribution of Securities (with the Securities-Contributing Limited Partner's investment being deemed to be made in the amount of the value ascribed to the Securities upon their contribution to the Partnership).

"For avoidance of doubt, neither the Cash-Contributing Limited Partners (under clause (1)) nor the Securities-Contributing Limited Partner (under clause (2)) shall be entitled to receive distributions under this Paragraph 6.4(i) which would cause their Capital Accounts to be negative by an amount which exceeds their Zero Balance Amounts (after all allocations to their Capital Accounts of Net Income or Loss and Capital Transaction Gain or Loss realized during a particular period under Article IV (without regard to Paragraph 11.2)). This Paragraph 6.4(i) shall not apply to or affect any distributions to E*TRADE with respect to its additional Capital Contributions pursuant to Paragraph 3.6 (and resulting allocations), and the portion of E*TRADE's Capital Account attributable to its additional Capital Contributions (and resulting allocations and distributions) shall not be considered for purposes of the foregoing sentence."

4. Paragraph 8.1(d)(2) is amended and restated to read in its entirety as follows:

"(2) to the Partners, in respect of the positive balances in their Capital Accounts, after all Capital Transaction Gain or Loss and Net Income or Loss (including amounts in connection with a distribution of Securities) has been allocated among the Partners. For avoidance of doubt, items of Capital Transaction Gain or loss and Net Income or Loss arising in any Fiscal Year or Interim Period during the winding up and dissolution of the Partnership shall be allocated in a manner such that the ending Capital Accounts (and resulting entitlement to distributions) of the Securities-Contributing Limited Partner attributable to its initial Capital Contribution of Securities and the Cash-Contributing Limited Partners are consistent with the distribution priorities established by Paragraph 6.4(i) of this Agreement."

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This Amendment shall be effective when approved by the General Partner and Two-Thirds in Interest of the Limited Partners; provided that (a) it shall only apply to allocations of Net Income or Loss and Capital Transaction Gain or Loss arising after the effective date and (b) shall not affect the allocations of Net Income or Net Loss or Capital Transaction Gain or Loss or distributions as between the Securities-Contributing Limited Partner and a Cash-Contributing Limited Partner unless such Limited Partner consents to this Amendment. Except as specifically set forth above, all other terms and provisions of the Agreement shall remain in effect and are not altered by this Amendment.

Exhibit 10.4

PROMISSORY NOTE

$4,078,000.00 Menlo Park, California

September 17, 2001

For value received, William Porter ("Borrower") promises to pay to the order of E*TRADE Group, Inc., a Delaware corporation ("Lender"), the principal sum of Four Million Seventy-Eight Thousand Dollars ($4,078,000)(the "Principal"), in lawful money of the United States of America, with interest thereon to be computed from date of the funding of this Note at the Interest Rate defined below, in accordance with the terms of this Note. The place of payment shall be 4500 Bohannon Drive, Menlo Park, California, or at such other place as the holder of this Note may from time to time require.

The Note, including both principal and interest, shall be payable on or before October 17, 2001.

The term Interest Rate as used in this Note shall mean a rate of interest equal to three and eighty-two one-hundredths percent (3.82%) per annum, compounded and paid annually. All computations of interest shall be made on the basis of a year of 360 days for the actual number of days occurring in the period for which such interest is payable.

All amounts payable under this Note are payable in lawful money of the United States. Checks constitute payment only when collected. This Note may be prepaid, in whole or in part, without penalty.

This Note is subject to the terms and conditions of the Loan Agreement, which, among other things, contains provisions for acceleration of the maturity of this Note.

This Note is governed by the laws of the State of California.

If Lender delays in exercising or fails to exercise any of its rights under this Note, that delay or failure shall not constitute a waiver of any of Lender's rights, or of any breach, default or failure of condition of or under this Note. No waiver by Lender of any of its rights, or of any such breach, default or failure of condition shall be effective, unless the waiver is expressly stated in a writing signed by Lender.

Notwithstanding anything to the contrary contained in this Note or the Loan Agreement, the interest rate applicable to this Loan and each advance hereunder shall be not less than the Applicable Federal Rate set by the U.S. Treasury for determining below market loans pursuant to Section 7872 of the Internal Revenue Code of 1986, as now in effect (the "Internal Revenue Code"). This Loan is not intended as a "below market loan" as such term is used in Section 7872 of the Internal Revenue Code, or any comparable applicable state tax law ("Below Market Loan"). The parties hereby agree

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that if any court or governmental taxing authority having jurisdiction over Borrower or Lender shall determine that this Loan is a Below Market Loan, the interest rate payable under this Note shall then be increased to the extent necessary to remove this Loan from any otherwise applicable definition of a Below Market Loan.

This Note inures to and binds the heirs, legal representatives, successors and permitted assigns of Borrower and Lender; provided, however, that Borrower may not assign this Note or any Loan funds, or assign or delegate any of her rights or obligations hereunder, without the prior written consent of Lender in each instance. Lender in its sole discretion may transfer this Note on the terms and subject to the conditions of the Loan Agreement, without the consent of Borrower.

IN WITNESS WHEREOF, Borrower has duly executed and delivered this Note to Lender as of the date first above written.

Borrower:

/s/ William Porter

William Porter

E*TRADE GROUP, INC.

STOCK PLEDGE AGREEMENT

AGREEMENT made as of this 17th day of September, 2001 by and between E*TRADE Group, Inc., a Delaware corporation (the "Corporation"), and William Porter ("Pledgor").

RECITALS

A. In connection with the loan to the Pledgor of Four Million Seventy-Eight Thousand Dollars ($4,078,000), Pledgor has issued that certain promissory note (the "Note") dated September 17, 2001 payable to the order of the Corporation.

B. Such Note is secured by the shares of common stock of E*TRADE Group, Inc. owned by the Purchaser upon the terms set forth in this Agreement.

NOW, THEREFORE, it is hereby agreed as follows:

1. **Grant of Security Interest.** Pledgor hereby grants the Corporation a security interest in, and assigns, transfers to and pledges with the Corporation, the following securities and other property (collectively, the "Collateral"):

(i) the Purchased Shares delivered to and deposited with the Corporation as collateral for the Note;

(ii) any and all new, additional or different securities or other property subsequently distributed with respect to the Purchased Shares which are to be delivered to and deposited with the Corporation pursuant to the requirements of Paragraph 3 of this Agreement;

(iii) any and all other property and money which is delivered to or comes into the possession of the Corporation pursuant to the terms of this Agreement; and

(iv) the proceeds of any sale, exchange or disposition of the property and securities described in subparagraphs (i), (ii) or (iii) above.

2. **Warranties.** Pledgor hereby warrants that Pledgor is the owner of the Collateral and has the right to pledge the Collateral and that the Collateral is free from all liens, adverse claims and other security interests (other than those created hereby).

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3. **Duty to Deliver.** Any new, additional or different securities or other property (other than regular cash dividends) which may now or hereafter become distributable with respect to the Collateral by reason of (i) any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the Common Stock as a class without the Corporation's receipt of consideration or (ii) any merger, consolidation or other reorganization affecting the capital structure of the Corporation shall, upon receipt by Pledgor, be promptly delivered to and deposited with the Corporation as part of the Collateral hereunder. Any such securities shall be accompanied by one or more properly-endorsed stock power assignments.

4. **Payment of Taxes and Other Charges.** Pledgor shall pay, prior to the delinquency date, all taxes, liens, assessments and other charges against the Collateral, and in the event of Pledgor's failure to do so, the Corporation may at its election pay any or all of such taxes and other charges without contesting the validity or legality thereof. The payments so made shall become part of the indebtedness secured hereunder and until paid shall bear interest at the minimum per annum rate, compounded semi-annually, required to avoid the imputation of interest income to the Corporation and compensation income to Pledgor under the Federal tax laws.

5. **Stockholder Rights.** So long as there exists no event of default under Paragraph 10 of this Agreement, Pledgor may exercise all stockholder voting rights and be entitled to receive any and all regular cash dividends paid on the Collateral and all proxy statements and other stockholder materials pertaining to the Collateral.

6. **Rights and Powers of Corporation.** The Corporation may, without obligation to do so, exercise at any time and from time to time one or more of the following rights and powers with respect to any or all of the Collateral:

(i) subject to the applicable limitations of Paragraph 9, accept in its discretion other property of Pledgor in exchange for all or part of the Collateral and release Collateral to Pledgor to the extent necessary to effect such exchange, and in such event the other property received in the exchange shall become part of the Collateral hereunder;

(ii) perform such acts as are necessary to preserve and protect the Collateral and the rights, powers and remedies granted with respect to such Collateral by this Agreement; and

(iii) transfer record ownership of the Collateral to the Corporation or its nominee and receive, endorse and give receipt for, or collect by legal proceedings or otherwise, dividends or other distributions made or paid with respect to the Collateral, provided and only if there exists at the time an outstanding event of default under Paragraph 10 of this Agreement. Any cash

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sums which the Corporation may so receive shall be applied to the payment of the Note and any other indebtedness secured hereunder, in such order of application as the Corporation deems appropriate. Any remaining cash shall be paid over to Pledgor.

Any action by the Corporation pursuant to the provisions of this Paragraph 6 may be taken without notice to Pledgor. Expenses reasonably incurred in connection with such action shall be payable by Pledgor and form part of the indebtedness secured hereunder as provided in Paragraph 12.

7. **Care of Collateral.** The Corporation shall exercise reasonable care in the custody and preservation of the Collateral. However, the Corporation shall have no obligation to (i) initiate any action with respect to, or otherwise inform Pledgor of, any conversion, call, exchange right, preemptive right, subscription right, purchase offer or other right or privilege relating to or affecting the Collateral, (ii) preserve the rights of Pledgor against adverse claims or protect the Collateral against the possibility of a decline in market value or (iii) take any action with respect to the Collateral requested by Pledgor unless the request is made in writing and the Corporation determines that the requested action will not unreasonably jeopardize the value of the Collateral as security for the Note and other indebtedness secured hereunder.

Subject to the limitations of Paragraph 9, the Corporation may at any time release and deliver all or part of the Collateral to Pledgor, and the receipt thereof by Pledgor shall constitute a complete and full acquittance for the Collateral so released and delivered. The Corporation shall accordingly be discharged from any further liability or responsibility for the Collateral, and the released Collateral shall no longer be subject to the provisions of this Agreement.

8. **Transfer of Collateral.** In connection with the transfer or assignment of the Note (whether by negotiation, discount or otherwise), the Corporation may transfer all or any part of the Collateral, and the transferee shall thereupon succeed to all the rights, powers and remedies granted the Corporation hereunder with respect to the Collateral so transferred. Upon such transfer, the Corporation shall be fully discharged from all liability and responsibility for the transferred Collateral.

9. **Release of Collateral.** Provided all indebtedness secured hereunder (other than payments not yet due and payable under the Note) shall at the time have been paid in full and there does not otherwise exist any event of default under Paragraph 10, the Purchased Shares, together with any additional Collateral which may hereafter be pledged and deposited hereunder, shall be released from pledge and returned to Pledgor in accordance with the following provisions:

(i) Upon payment or prepayment of principal under the Note, together with payment of all accrued interest to date on the principal amount so paid or prepaid, one or more of the Purchased Shares held as Collateral hereunder shall (subject to the applicable limitations of Paragraphs 9(iii) and 9(v) below) be released at the time of such payment or prepayment. The number of the shares to be so released shall be equal to the number obtained by multiplying (i) the total number of Purchased Shares held under this Agreement at the time of the payment or prepayment, by (ii) a fraction, the numerator of which shall be the amount of the principal paid or prepaid and the denominator of which shall be the unpaid principal balance of the Note immediately prior to such payment or prepayment. In no event, however, shall any fractional shares be released.

(ii) Any additional Collateral which may hereafter be pledged and deposited with the Corporation (pursuant to the requirements of Paragraph 3) with respect to the Purchased Shares shall be released at the same time the particular shares of Common Stock to which the additional Collateral relates are to be released in accordance with the applicable provisions of Paragraph 9(i) or 9(vi).

(iii) Under no circumstances, however, shall any Purchased Shares or any other Collateral be released if previously applied to the payment of any indebtedness secured hereunder. In addition, in no event shall any Purchased Shares or other Collateral be released pursuant to the provisions of Paragraph 9(i), 9(ii) or 9(vi) if, and to the extent, the fair market value of the Common Stock and all other Collateral which would otherwise remain in pledge hereunder after such release were effected would be less than the unpaid principal and accrued interest under the Note.

(iv) For all valuation purposes under this Agreement, the fair market value per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(A) If the Common Stock is at the time traded on the Nasdaq National Market, the fair market value shall be the average of the high and low selling prices per share of Common Stock on the date in question, as such prices are reported by the National Association of Securities Dealers on the Nasdaq National Market. If there is no average of the high and low selling prices for the Common Stock on the date in question, then the average of the high and low selling prices on the last preceding date for which such quotation exists shall be determinative of fair market value.

(B) If the Common Stock is at the time listed on the American Stock Exchange or the New York Stock Exchange, then the fair market value shall be the average of the high and low selling prices selling prices per share of Common Stock on the date in question on the securities exchange serving as the primary market for the Common Stock, as such prices are officially quoted in the composite tape of transactions on such exchange. If there is no average of the high and low selling prices of Common Stock on such exchange on the date in question, then the fair market value shall be the average of the high and low selling prices on the exchange on the last preceding date for which such quotation exists.

(C) If the Common Stock is at the time neither listed on any securities exchange nor traded on the Nasdaq National Market, the fair market value shall be determined by the Corporation's Board of Directors after taking into account such factors as the Board shall deem appropriate.

(v) So long as the Collateral is in whole or in part comprised of "margin stock" within the meaning of Section 221.2 of Regulation U of the Federal Reserve Board, then no Collateral shall be substituted for any Collateral under the provisions of Paragraph 6(i) or be released under Paragraph 9(i), 9(ii) or 9(vi), unless there is compliance with each of the following additional requirements:

(A) The substitution or release must not increase the amount by which the indebtedness secured hereunder at the time of such substitution or release exceeds the maximum loan value (as defined below) of the Collateral immediately prior to such substitution or release.

(B) The substitution or release must not cause the amount of indebtedness secured hereunder at the time of such substitution or release to exceed the maximum loan value of the Collateral remaining after such substitution or release is effected.

(C) For purposes of this Paragraph 9(v), the maximum loan value of each item of Collateral shall be determined on the day the substitution or release is to be effected and shall, in the case of the shares of Common Stock and any additional Collateral (other than margin stock), equal the good faith loan value thereof (as defined in Section 221.2 of Regulation U) and shall, in the case of all margin stock (other than the Common Stock), equal fifty percent (50%) of the current market value of such margin stock.

(vi) The Compensation Committee of the Corporation's Board of Directors shall have the discretion, exercisable upon such terms and conditions as the Compensation Committee deems advisable, to authorize the release of one or more shares of Common Stock from pledge hereunder in the event the maximum loan value of the Collateral pledged hereunder (as such value is determined pursuant to subparagraph 9(v)(C)) should substantially exceed the outstanding indebtedness at the time secured hereunder. Any such release of the pledged shares of Common Stock shall, however, be effected in compliance with the requirements of subparaphs (iii) and (v) of this Paragraph 9.

10. **Events of Default.** The occurrence of one or more of the following events shall constitute an event of default under this Agreement:

(i) the failure of Pledgor to pay, when due under the Note, any installment of principal or accrued interest; or

(ii) the occurrence of any other acceleration event specified in the Note; or

(iii) the failure of Pledgor to perform any obligation imposed upon Pledgor by reason of this Agreement; or

(iv) the breach of any warranty of Pledgor contained in this Agreement.

Upon the occurrence of any such event of default, the Corporation may, at its election, declare the Note and all other indebtedness secured hereunder to become immediately due and payable and may exercise any or all of the rights and remedies granted to a secured party under the provisions of the California Uniform Commercial Code (as now or hereafter in effect), including (without limitation) the power to dispose of the Collateral by public or private sale or to accept the Collateral in full payment of the Note and all other indebtedness secured hereunder.

Any proceeds realized from the disposition of the Collateral pursuant to the foregoing power of sale shall be applied first to the payment of expenses incurred by the Corporation in connection with the disposition, then to the payment of the Note and finally to any other indebtedness secured hereunder. Any surplus proceeds shall be paid over to Pledgor. However, in the event such proceeds prove insufficient to satisfy all obligations of Pledgor under the Note, then Pledgor shall remain personally liable for the resulting deficiency.

11. **Other Remedies.** The rights, powers and remedies granted to the Corporation pursuant to the provisions of this Agreement shall be in addition to all rights, powers and remedies granted to the Corporation under any statute or rule of law. Any forbearance, failure or delay by the Corporation in exercising any right, power or remedy under this Agreement shall not be deemed to be a waiver of such right, power or remedy. Any single or partial exercise of any right, power or remedy under this Agreement shall not preclude the further exercise thereof, and every right, power and remedy of the Corporation under this Agreement shall continue in full force and effect unless such right, power or remedy is specifically waived by an instrument executed by the Corporation.

12. **Costs and Expenses.** All costs and expenses (including reasonable attorneys fees) incurred by the Corporation in the exercise or enforcement of any right, power or remedy granted it under this Agreement shall become part of the indebtedness secured hereunder and shall constitute a personal liability of Pledgor payable immediately upon demand and bearing interest until paid at the minimum per annum rate, compounded semi-annually, required to avoid the imputation of interest income to the Corporation and compensation income to Pledgor under the Federal tax laws.

13. **Applicable Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of California without resort to that State's conflict-of-laws rules.

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14. **Successors.** This Agreement shall be binding upon the Corporation and its successors and assigns and upon Pledgor and the executors, heirs and legatees of Pledgor's estate.

15. **Severability.** If any provision of this Agreement is held to be invalid under applicable law, then such provision shall be ineffective only to the extent of such invalidity, and neither the remainder of such provision nor any other provisions of this Agreement shall be affected thereby.

IN WITNESS WHEREOF, this Agreement has been executed by Pledgor and the Corporation on this 17th day of September, 2001.

/s/ William Porter

____

PLEDGOR

Address: ______________________________

____

AGREED TO AND ACCEPTED BY:

E*TRADE GROUP, INC.

By: */s/ Russell S. Elmer*

Title: Chief Legal Affairs and Human Resources Officer

Dated: September 17, 2001

ASSIGNMENT SEPARATE FROM CERTIFICATE

FOR VALUE RECEIVED, _______________ hereby sells, assigns and transfers unto E*TRADE Group, Inc. (the "Corporation"),__________ (____) shares of the Common Stock of the Corporation standing in his name on the books of the Corporation represented by Certificate No. _________herewith and does hereby irrevocably constitute and appoint __________________Attorney to transfer the said stock on the books of the Corporation with full power of substitution in the premises.

Dated:

Signature: */s/ William Porter*

William Porter

Instruction: Please do not fill in any blanks other than the signature line. Please sign exactly as you would like your name to appear on the issued stock certificate.

Exhibit 10.5

SECOND AMENDED EMPLOYMENT AGREEMENT

This Agreement is made effective this 27th day of August, 2001 (the "Effective Date"), by and between E*TRADE GROUP, INC., a Delaware corporation ("Company"), and CHRISTOS M. COTSAKOS, ("Executive").

BACKGROUND

Executive, Chairman of the Board and Chief Executive Officer of Company, began his service with the Company pursuant to an Employment Agreement dated as of March 15, 1996 (the "Prior Agreement"). Effective June 1, 1999 Executive and the Company entered into a new employment agreement (the "Employment Agreement") the terms of which superseded the Prior Agreement.

Effective October 1, 2000, Executive and the Company entered into an Amended Employment Agreement, incorporating certain modifications following the Company's annual review of Executive's employment (the "Amended Employment Agreement"). In adopting the Amended Employment Agreement, the Board of Directors of the Company and the Compensation Committee of the Company noted the unique and singular contribution that the Executive has made to the Company. They noted that paramount to the Company's interest is insuring the Executive's retention and securing that his skills and abilities remain focused on the continued growth and leadership of the Company. They noted that the vision and energetic commitment that the Executive has demonstrated during his tenure as Chief Executive Officer has been and continues to be a fundamental and essential asset of the Company. They noted the efforts of the Executive are recognized as profoundly and positively impacting on the long-term value of the shareowners' interests in the Company. The Executive has left an indelible mark on the Company's culture and its values. In addition he has and continues to greatly influence the course of e-commerce and the financial services industry at large. In particular, the Compensation Committee of the Company made note of management's ability to exceed the performance expectation for the Company in both positive and negative market conditions and achieving profitability 12 months earlier than expected. In recognition of these accomplishments and in order to continue to achieve ambitious goals for the performance of the Company, the parties modified certain terms of the Employment Agreement and added certain other terms to the Employment Agreement.

Since the adoption of the Amended Employment Agreement, Executive has continued to make a unique and singular contribution to the Company. Notwithstanding Executive's continued extraordinary performance, the parties have discussed that certain provisions of the Employment Agreement as amended could result in a significant expense to the Company, particularly in the event of a termination of Executive's employment following a Change in Control of the Company. To enable the Company to more freely consider different business opportunities and/or combinations, and in consideration of the settlement of certain other arrangements, Company and Executive have agreed to revise certain of the agreements existing between them.

Therefore, in consideration of the promises and the mutual covenants and agreements set forth herein, the parties agree to enter into this Second Amended Employment Agreement as follows:

TERMS AND CONDITIONS

In consideration of the premises and the mutual covenants and agreements set forth below, the parties agree as follows:

1. Termination of Prior Agreement. The Prior Agreement shall terminate and be of no further force and effect as of the date of this Agreement.

2. Employment. Executive agrees to serve as Chief Executive Officer of Company, and as Chairman of the Company's Board of Directors, for the term of this Agreement, subject to the terms set forth in this Agreement and the provisions of the Bylaws of Company. During his employment, Executive shall devote his effort and attention, on a full–time basis, to the performance of the duties required of him as an executive of Company. Notwithstanding the foregoing, Executive shall be entitled to serve as director (including service as the Board chairman) on the governing boards of other for–profit or not–for–profit entities and to retain any compensation and benefits resulting from such service, so long as such service does not unduly interfere with his duties under this Agreement.

3. Compensation. As compensation for his services during the term of this Agreement, Executive shall receive the amounts and benefits set forth in this Section 3 all effective as of the Effective Date unless otherwise specified:

(a) An annual salary of $690,000 ("Base Salary") prorated for any partial year of employment. As soon as reasonably practicable after the close of Company's current fiscal year and the close of each fiscal year thereafter, the Base Salary shall be subject to review by the Compensation Committee of the Company's Board of Directors for increases in light of the size and performance of Company. The Base Salary, as adjusted in accordance with this subsection (a), shall remain in effect unless and until it is increased in accordance with this subsection (a). Executive's salary shall be payable semimonthly or in accordance with Company's regular payroll practices in effect from time to time for officers of his level in Company.

(b) Participation in the Company's management bonus plan, with bonus payments to be determined and paid in accordance with the terms of the plan. The bonus will be determined by multiplying: (x) the percentage established by the Compensation Committee (not to be less than 3 times); and (y) the Executive's then current base salary.

(c)(i) Participation in the employee benefit plans maintained by Company and in other benefits provided by Company to senior executives, including retirement and 401(k) plans, deferred compensation, medical and dental, annual vacation, paid holidays, sick leave, and similar benefits, which are subject to change from time to time at the reasonable discretion of Company.

(c)(ii) Participation in the Supplemental Executive Retirement Plan specifically including the term "Covered Wages" to be defined as the total of the base salary as of the termination date and the targeted bonus at a minimum of three times base salary (or such higher amount then in effect pursuant to sections 3 (a) & (b)) for the plan year which includes the termination.

(d) Participation in any Company sponsored incentive arrangements, including participation as a partner in any venture arrangements originated or sponsored by Company.

(e) Reimbursement of membership dues and related ongoing costs of appropriate club and professional organizations; and dues, costs and expenses for appropriate, continuing professional education, financial and legal counseling, planning and administration (including any reasonable legal insurance costs).

(f) It is acknowledged that Executive has received option with specific terms and conditions provided therein. Company agrees that there will be no change made in any Stock Option during the term of Executive's employment hereunder which adversely affects Executive's rights as established by the foregoing documents, without the prior written consent of Executive. With respect to the stock option grant dated April 22, 1999 and with respect to any subsequent stock options granted to Executive, regardless of any other terms to the contrary, in no event with the expiration date for exercise be less than 10 years from date of grant. In the event of death or disability, all time-based vesting restrictions applicable to all stock options, current and hereinafter granted, and outstanding to Executive at the time of his death or disability shall accelerate as of such time and thereafter not restrict the exercisability of any such options held by Executive or his estate. In the event of an involuntary termination of Executive associated with a Change in Control, as defined in Section 6(f)(iii), all time-based vesting restrictions applicable to all stock options, current and hereinafter granted, and outstanding to Executive at the time the Change in Control shall accelerate as of such time and thereafter not restrict the exercisability of any such options held by Executive.

(g) Lease of automobile for company use and reimbursement of reasonable operating expense.

(h) Reimbursement of all reasonable business–related expenses, including without limitation, first–class air travel or chartered aircraft. At the discretion of Executive, immediate family members are permitted to accompany Executive.

(i) Reimbursement of tuition, fees, books, ancillary expenses including the cost of research assistants, travel, hotel and meal expenses relating to completion of Ph.D. program, or other executive projects such as speech writing, publishing and similar endeavors.

(j) Reimbursement for the cost of a comprehensive security, executive protection and monitoring system that may be installed in Executive's vehicles and or aircraft and at Executive's residences (and the residences and vehicles of immediate family members), including (but not limited to) structural costs and related equipment. Included in this area are reimbursement for the cost of equipment, labor or other costs associated with the installation of technology and communication equipment in Executive's residences integrated with the equipment and transmission and reception capabilities in Executive's corporate office.

(k) Reimbursement for the use of aircraft owned or controlled by Executive (and/or by his affiliates), all in accordance with the policies to be determined in conjunction with Company.

(l) Company shall purchase a split-dollar insurance policy on Executive's life, payable to Executive's designated beneficiary, in the face amount of $10,000,000. Company shall also establish a bonus arrangement to enable a "roll-out"

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of the policy on a tax-free basis to Executive at his targeted retirement date, as defined by Executive in writing. In the event of a termination of employment prior to retirement, Executive shall be entitled to receipt of the policy and a bonus in the amount required to cover all applicable income taxes on such transfer, fully grossed up.

(m) Executive shall be provided, at his discretion, with a loan at the lowest applicable interest rate, to purchase from the company or its subsidiaries any transportation equipment.

(n) "Gross-up" payments to cover taxes due in the event any of the benefits described in subsections (e), (g), (h), (i), (j), (k) and (l) above, or in Section 6(c), are taxable to Executive.

4. In addition to any other compensation paid to Executive pursuant to this agreement or otherwise awarded to Executive by the Compensation Committee of the Company's Board of Directors, Executive will receive the Special Enterprise Enhancement Payment award provided by this section. The award will be paid within 30 days after the closing of a "qualified event". For this purpose, a "qualified event" is an event consummated prior to January 3, 2000, and defined in Section 6(f)(iii) entitled "Change in Control" hereinafter provided. The amount of the award will be based on the increase of the Enterprise Value (i.e. of the Company as hereinbefore defined) from August 12, 1999, to the qualified event (based on the respective closing market prices as represented on the established exchange on which the company's shares are regularly traded. If, however, a greater per share price is stated in any document creating, upon closing, a "qualified event" then that price shall be utilized herein.) The Enterprise Value shall be the market capitalization to be calculated inclusive of all fully diluted shares as represented on the financial statements of the Company on which the company's independent accountants render an opinion thereon. For this purpose only, the initial value will use the share information as of August 12, 1999 with the appropriate market price as of the same date for the effective date of this measurement. To the extent there has been an increased value as of the "qualified event", the Executive will receive an award of eighteen thousands of one percent (0.018%) multiplied by such increase.

5. Term. The term of this Agreement and the termination rights are as follows:

(a) This Agreement and Executive's employment under this Agreement shall be effective as of the Effective Date and shall continue for a term ending on May 31, 2002 (the "Initial Term"). This Agreement and Executive's employment shall automatically continue for successive one-year periods at the end of the Initial Term, unless either party gives written notice to the other of its intent to terminate this Agreement and Executive's employment not less than 180 days prior to the commencement of any such one-year renewal period. In the event such notice to terminate is properly given, this Agreement and Executive's employment shall terminate at the end of the Initial Term or the one-year renewal period during which the notice is given.

(b) This Agreement and Executive's employment may be terminated by either party prior to the end of the Initial Term (or any renewal period) upon 30 days' prior written notice to the other party, provided that, in the event of such termination, Company shall be obligated to make the payments and provide the benefits described in Section 6 below.

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6. Termination Payments. Upon termination of Executive's employment, Company shall pay to Executive, within three business days after the end of the 30–day notice period provided in Section 5 above, a payment in cash determined under subsection (a) or (b) of this Section 6 and shall for the period or at the time specified provide the other benefits described in subsections (c) and (e) of this Section 6:

(a) The payment shall be equal to five full years of Executive's "Current Total Annual Compensation" as defined in subsection (f) of this Section 6, if: (i) Executive's employment is terminated by Company, other than for Cause, within three years after any "Change in Control" of Company as defined in subsection (f) of this Section 6, or at the request of or pursuant to an agreement with a third party who has taken steps reasonably calculated to effect a Change in Control, or otherwise in connection with or in anticipation of a Change in Control; or (ii) Executive elects to terminate employment for Good

Reason within three years after any Change in Control of Company. In addition, in the event that Executive's employment is terminated in the circumstances described in this subsection, the Company shall also forgive any and all loans between Executive and the Company or its subsidiaries that are outstanding at the time of such termination, whether such loans are for the exercise of stock options or any other purpose. The Company shall also pay Executive a "gross-up" payment to cover taxes due from the forgiveness of any such loan.

(b) The payment shall be equal to four full years of Executive's Current Total Annual Compensation if (i) Executive's employment is terminated by Company, other than for Cause, and such termination is not described in (a) above; or (ii) Executive elects to terminate his employment for "Good Reason," as defined in subsection (f) of this Section 6, and such termination is not described in (a) above. In addition, in the event that Executive's employment is terminated in the circumstances described in this subsection, the Company shall also forgive any and all loans between Executive and the Company or its subsidiaries that are outstanding at the time of such termination, whether such loans are for the exercise of stock options or any other purpose. The Company shall also pay Executive a "gross-up" payment to cover taxes due from the forgiveness of any such loan.

(c) In addition to the amount payable to Executive under subsection (a) or (b) of this Section 6, Executive shall be entitled to the following upon termination for any reason:

(i) The health care (including medical and dental) and life insurance coverage benefits provided to Executive and his Spouse at his date of termination, shall be continued at the same level and in the same manner for the rest of their lives. Any additional coverages Executive had at termination, including dependent coverage, will also be continued for such period on the same terms. Any costs Executive was paying for such coverages at the time of termination shall continue to be paid by Executive. If the terms of any benefit plan referred to in this section do not permit continued participation by Executive, then Company will arrange for other coverage providing substantially similar benefits at the same contribution level of Executive.

(ii) Outplacement and financial and legal counseling services selected by Executive, up to a maximum of $100,000 each (net of tax, if any).

(iii) A mutually acceptable office, together with secretarial assistance and customary office facilities and services, located at Company (or in lieu thereof

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reimbursement for same at another location), for up to 36 months following the effective termination date of this Agreement, for the purpose of facilitating Executive's search for new employment.

(d) The Employee's employment shall terminate in the event of death. The Company shall pay to the Executive's surviving spouse or family trust (or estate, if none), the payment provided under this Section 6 and shall continue to pay the Base Salary plus most recent bonus amount for the remaining term of the contract. The Executive's rights under the benefit plans of the Company shall be determined under the provisions of those plans.

(e) The Company may terminate the Employee's employment for Disability by giving the Employee six months' advance notice in writing. Disability is defined in subsection (f)(vi) of this Section 6. Upon the effective date of a termination for Disability, the Company will pay to the Executive the payment provided under subsection (b) of this Section 6. In the event of disability, the Executive's rights under the benefit plans of the Company shall be determined under the provisions of those plans.

(f) For purposes of this Agreement, the following definitions shall apply:

(i) The "Board" shall mean the Board of Directors of Company.

(ii) The "Incumbent Board" shall mean the members of the Board as of the date of this Agreement and any person becoming a member of the Board hereafter whose election, or nomination for election by Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of Company).

(iii) "Change in Control" shall mean:

(A) The acquisition (other than from Company) by any person, entity or "group," within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act (excluding, for this purpose, any employee benefit plan of Company or its subsidiaries which acquires beneficial ownership of voting securities of Company) of beneficial ownership (within the meaning of Rule 13d–3 promulgated under the Exchange Act) of 40% or more of either the then outstanding shares of Common Stock or the combined voting power of Company's then outstanding voting securities entitled to vote generally in the election of directors; or

(B) The failure for any reason of individuals who constitute the Incumbent Board to continue to constitute at least a majority of the Board; or

(C) Approval by the stockholders of Company of a reorganization, merger, consolidation, in each case, with respect to which the shares of Company voting stock outstanding immediately prior to such reorganization, merger or consolidation do not constitute or become exchanged for or converted into more than 40% of the combined voting power entitled to vote generally in the election of directors of the reorganized, merged or consolidated company's then outstanding voting securities, or a liquidation or dissolution of Company or of the sale of all or substantially all of the assets of Company

(iv) "Good Reason" shall mean:

(A) The assignment to Executive of any duties inconsistent in any respect with Executive's position (including status, offices, titles and reporting requirements), authority, duties or responsibilities as contemplated by Section 2 above, or any other action by Company which results in a diminution of such position, authority, duties or responsibilities, excluding for this purpose any action taken with the consent of Executive and any isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by Company promptly after receipt of notice of such action given by Executive;

(B) A reduction in the overall level of Executive's compensation or benefits as provided in Section 3;

(C) Company's requiring Executive to be based at any office or location other than Company's executive offices in Menlo Park, California environs, except for travel reasonably required in the performance of Executive's responsibilities;

(D) Any purported termination by Company of Executive's employment otherwise than as expressly permitted by this Agreement; or

(E) Any failure by Company to comply with and satisfy Section 7 below.

(F) The nomination by the Board of a Chairman (or person serving in a similar capacity) of a person other than Executive.

For purposes of this Agreement, any good–faith determination of "Good Reason" made by Executive shall be conclusive.

(v) **"Current Total Annual Compensation"** shall be the total of the following amounts: (A) the greater of (i) Executive's Base Salary for the greater of the calendar or fiscal year (the "Applicable Year") in which his employment terminates or (ii) such salary for the Applicable Year prior to the year of such termination; and (B) the greater of (i) any total that became payable to Executive under the Bonus Plan during the Applicable Year prior to the Applicable Year in which his employment terminates and (ii) the maximum total bonus amount to which Executive would be and had been paid for the Applicable Year in which his employment terminates as if all Bonus Plan criteria had been or are met, regardless of when such amounts are actually to be paid or had been paid. Any longer term Bonus Plan payments are to be accelerated and included within the meaning of this definition.

(vi) **"Disability"** shall mean the total and permanent inability of Executive due to illness, accident or other physical or mental incapacity to perform the usual duties of his employment under this Agreement, as determined by a physician selected by Company and acceptable to Executive or Executive's legal representative (which agreement as to acceptability shall not be unreasonably withheld).

(vii) The **"Exchange Act"** shall mean the Securities Exchange Act of 1934, as amended.

(viii) **"Cause"** shall be defined solely as (i) Executive's defalcation or misappropriation of funds or property of the Company, or the commission of any other illegal act in the course of his employment with Company which, in the reasonable judgment of the Board of Directors, has a material adverse financial effect on the Company or on

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Executive's ongoing abilities to carry out his duties under this Agreement; (ii) Executive's conviction of a felony or of any crime involving moral turpitude, and affirmance of such conviction following the exhaustion of any appeals; (iii) refusal of Executive to substantially perform all of his duties and responsibilities, or Executive's persistent neglect of duty or chronic unapproved absenteeism (other than for a temporary or permanent Disability), which remains uncured following thirty days after written notice of such alleged Cause by the Board of Directors; or (iv) any material and substantial breach by Executive of other terms and conditions of this Agreement, which, in the reasonable judgment of the Board of Directors, has a material adverse financial effect on the Company or on Executive's ongoing abilities to carry out his duties under this Agreement and which remains uncured following thirty days after written notice of such alleged Cause by the Board of Directors.

(g) In addition to the amounts payable and/or forgiven under subsection (a), (b) or (c) of this Section 6, Company shall pay Executive a tax equalization payment in accordance with this subsection. The tax equalization payment shall be in an amount which, when added to the other amounts payable to Executive under this Section 6, will place Executive in the same after-tax position as if the excise tax penalty of Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"), or any successor statute of similar import, did not apply to any of the amounts payable under this Section 6 including any amounts paid under this subsection (g). The amount of this tax equalization payment shall be determined by Company's independent accountants and shall be payable to Executive at the same time as the payment under subsection (a) or (b) of this Section 6.

7. **Assignment; Successors.** Any assignment of this Agreement shall be in accordance with the following:

(a) The rights and benefits of Executive under this Agreement, other than accrued and unpaid amounts due hereunder, are personal to him and shall not be assignable by Executive, except with the prior written consent of Company.

(b) Subject to the provisions of subsection (c) of this Section 7, this Agreement shall not be assignable by Company, provided that with the consent of Executive, Company may assign this Agreement to another corporation wholly owned by it either directly or through one or more other corporations, or to any corporate successor of Company or any such corporation.

(c) Any business entity succeeding to substantially all of the business of Company, by purchase, merger, consolidation, sale of assets or otherwise, shall be bound by and shall adopt and assume this Agreement, and Company shall require the assumption of this Agreement by such successor as a condition to such purchase, merger, consolidation, sale of assets or other similar transaction.

8. **Notices.** Any notice or other communications under this Agreement shall be in writing, signed by the party making the same, and shall be delivered personally or sent by certified or registered mail, postage prepaid, addressed as follows:

If to Executive; Mr. Christos M. Cotsakos
c/o E*Trade Group, Inc.
4500 Bohannon Drive
Menlo Park, California 94025

If to Company; The Board of Directors
c/o E*Trade Group, Inc.
4500 Bohannon Drive
Menlo Park, California 94025

or such other address or agent as may hereafter be designated by either party hereto. All such notices shall be deemed given on the date personally delivered or mailed.

9. **Full Settlement and Legal Expenses.** Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any set-off, counter-claim, recoupment, defense or other claim, right or action which Company may have against Executive or others. In no event shall Executive be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to Executive under any of the provisions of this Agreement. The prevailing party shall be entitled to recover all legal fees and expenses which such party may reasonably incur as a result of any legal proceeding relating to the validity, enforceability, or breach of, or liability under, any provision of this Agreement or any guarantee of performance (including as a result of any contest by Executive about the amount of any payment pursuant to Section 6 of this Agreement), plus in each case interest at the applicable Federal Rate provided for in Section 7872(f)(2) of the Code.

10. **Governing Law.** This Agreement shall be interpreted and enforced in accordance with the laws of the State of California, except that any

arbitration shall be governed by the Federal Arbitration Act.

11. **Severability.** Whenever possible, each provision of this Agreement shall be interpreted in such manner as to be effective and valid, but if any one or more of the provisions contained in this Agreement shall be invalid, illegal or unenforceable in any respect for any reason, the validity, legality and enforceability of any such provisions in every other respect and of the remaining provisions of this Agreement shall not be in any way impaired.

12. **Entire Agreement.** This Agreement (including all Exhibits) contains the entire agreement of the parties with respect to the subject matter contained in this Agreement. There are no restrictions, promises, covenants, or undertakings between Company and Executive, other than those expressly set forth in this Agreement. This Agreement supersedes all prior agreements and understandings between the parties. This Agreement may not be amended or modified except in writing executed by the parties.

13. **Arbitration.** Any controversy or claim arising out of or relating to this Agreement shall be settled by arbitration in accordance with the American Arbitration Association's National Rules for the Resolution of Employment Disputes, and judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction. Any arbitration shall be held in Santa Clara County, California, unless otherwise agreed in writing by the parties.

IN WITNESS WHEREOF, the undersigned have executed this Agreement as of the day and year first above written.

E*TRADE GROUP, INC.

[CORPORATE SEAL]

/s/ David Hayden

David Hayden
Audit Committee

/s/ William Ford

William Ford
Compensation Committee

EXECUTIVE

/s/ Christos M. Cotsakos

Christos M. Cotsakos