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MANAGEMENT DISCUSSION SECTION

Operator

Introduction.

Safe Harbor Statement.

In this call, E*TRADE Financial will discuss some non-GAAP measures in talking about its performance, and you can find a reconciliation of those measures to GAAP in the company's press release, which can be found on its website.

This call is being taped. The recording will be available by telephone beginning at approximately 7:00 p.m. Eastern Time today through 5:00 p.m. Eastern Time October 31st. The call is also being webcast at www.etrade.com. No other tape recordings of this call or copies of the taping are authorized or may be relied upon.

I will now turn the call over to Mitchell Caplan, Chief Executive Officer of E*TRADE Financial Corporation, who is joined by Jarrett Lilien, President and Chief Operating Officer, and Len Purkis, Chief Financial Officer. Mr. Caplan?

Mitchell Caplan, Chief Executive Officer

Thanks, everyone, for joining us this afternoon. Results often speak louder than words. For the past 3 quarters, we've spoken about our focus on innovation and discipline. We have described our role as a customer champion. We have talked of the power inherent in our motto, which provides opportunity in all types of economic environments, but perhaps our results speak more eloquently. I am pleased to announce that in this past quarter, we produced the best fiscal results in the company's history.

For the quarter, we produced GAAP earnings of $0.17 per share, up from $0.03 last quarter and $0.06 a year ago. These results included a strategic rebalancing in our corporate equity investment portfolio that generated a $41 million gain in the quarter. Specifically, this sale generated $65 million in cash that has been redeployed to support growth initiatives in other parts of the business. In addition, the GAAP results include a previously announced charge of $47 million related to restructuring and other exit activity.

The company's earnings from ongoing operations were also $0.17 per share, up from $0.14 in the prior quarter and $0.12 in the prior year. Our operating leverage is evident. In the first 3 quarters of 2003, we have produced earnings from ongoing operations of $0.40 per share, roughly 29% greater than the first 3 quarters of 2002 and nearly 700% greater than the first 3 quarters of 2001.

Our focus for the remainder of this year and beyond will be to continue to use our technology to create customer and competitive advantage. We can and will continue to become more scalable, more efficient, and more customer friendly.

Our brokerage business delivered strong results in this past quarter. Total revenue trades increased 15% from the prior quarter, while total DARTs increased 13% from the prior quarter and 49% year-over-year.

Net brokerage revenues were $238 million, up 7% from last quarter, and represented 60% of total revenue. Based on segment reporting, and excluding charges from restructuring and exit activity, after-tax brokerage operating income increased 65% quarter-over-quarter to $0.09 per share, and now represents 53% of our total segment operating income, up from 17% in Q1 of this year.

These results were delivered in what has traditionally been a slow period for brokerage volume. Our success is attributable to 2 factors: our efficient platform, which converts increased trading activity into profit, and our value proposition, which continues to drive market share gains.

Across the industry, trading volumes increased as retail investors showed an encouraging desire to reenter the equity markets. We've benefited from this reengagement, as our breakeven point held at 50,000 trades per day, down from 65,000 last year. Incremental volume above our breakeven point carries a pre-tax margin of approximately 85%. Based on this dynamic and synergies with our market-making and institutional brokerage operations, every additional 10,000 DARTs translates into approximately $0.015 of quarterly EPS, or $0.06 per year depending on volume mix.

During the quarter, increased trading volume boosted earnings per share from brokerage operations by approximately $0.02. For the fifth consecutive quarter, we believe that we gained market share of total online trading volumes. DARTs from our US customer segment increased 8% sequentially to 75,000 during the quarter. The broad appeal of our trading platform is also resonating well in our international and professional customer segments, where volumes continue to show solid growth.

In our international markets, a heightened focus on active traders helped drive a 24% quarterly increase in DARTs. International DARTs improved to 8,600, more than doubling totals from a year ago. We're extremely pleased by the growth in the international segment, as these trades carry the highest average commissions of our 3 retail brokerage sub-segments. Through a combination of this growth and our increased operational efficiencies, our international retail brokerage operations, in aggregate, were profitable and cash flow positive this quarter for the first time.

We delivered these results as many of our competitors withdrew, leaving us an opportunity for future growth.

DARTs from our professional customer segment increased 18% sequentially in the quarter and 53% year-over-year to over 48,000 per day. Total DARTs for the month of September increased 29% over August, and US DARTs increased 33%, demonstrating the continued strength in retail trading activity through the end of the quarter. For additional monthly metrics and historical DART information, visit our Investor Relations web page at web www.etrade.com.

Clearly, our value proposition is resonating well, because we offer our customers the right mix of pricing, functionality, service and convenience. In addition, during the quarter, we enhanced our trading platform for E*TRADE professional customers by offering Euro FX and Japanese yen currency contracts in either the full size or E-mini version. Through one single platform, these customers can now trade these foreign exchange futures and E-mini contracts in the S&P 500, Russell 2000, NASDAQ 100, and S&P Mid-Cap 400 market indices.

As investor confidence and market volumes improve, margin debt increases. During the quarter, customer margin debt balances grew at roughly the same pace as total DARTs. Total end of period margin debt balances increased 23% to $1.5 billion and have increased by approximately 62% from a low of $900 million during the first quarter of 2003. Since the beginning of the year, margin debt balances have increased by $480 million. Still, total balances remain below levels seen as recently as the first quarter of 2002, and materially below the peak level of Q1 2000, when total margin debt exceeded $6 billion. Every $400 million incremental increase in total margin debt adds $0.01 in EPS per quarter or $0.04 per year. During the quarter, increased margin debt improved quarter-over-quarter earnings by $0.005 per share.

Our focus on higher value customers is translating into higher quality brokerage accounts. Since the beginning of the year, revenue per brokerage account has increased by 44% to $83.29 per quarter, while annualized revenue trades per account have increased to 11.8 from 6.6.

The banking group's balanced and diversified model also produced strong quarterly earnings. The mortgage market remained active through July, driving strong results from our correspondent and retail mortgage businesses. As in past quarters, the strengths of the mortgage market resulted in high levels of prepayments, which adversely affected our net interest spread. Based on segment reporting and excluding charges from restructuring and exit activity, after-tax banking operating income was $0.08 per share and now represents 47% of our total segment operating income, down from 83% in Q1. Included in the banking group's results is a $6 million expense, or $0.01 per share, associated with our settlement of litigation related to claims for payment of overtime wages for certain categories of employees at E*TRADE Mortgage.

Since late last year, we have spoken about an impending slowdown in the mortgage market. That slowdown has occurred as industry-wide refinance volumes fell sharply in September. In anticipation of this decline, we shifted our focus toward 3 initiatives aimed at repositioning the bank's balance sheet to succeed in a flat to rising interest rate environment. These 3 areas include: increasing net interest income by lowering our cost of funds and by diversifying our asset portfolio; shifting the focus of our lending business towards consumer finance products and purchase money mortgages; and reaching greater levels of scale and efficiency by continuing to grow the balance sheet. We continue to lower our cost of funds by emphasizing transactional accounts.

Late in the quarter, we introduced the E*TRADE Financial Sweep Deposit Account to some brokerage customers. The sweep account provides FDIC insurance and higher rates than our general money market fund and retains the same ease of use and functionality that customers have always enjoyed. During the quarter, we converted $2.8 billion of funds from brokerage money market to bank sweep accounts, and we anticipate that we will convert approximately an additional $1.3 billion in Q4. The sweep account is a good product for our customers and a cost-efficient source of funding for the bank.

We also remain committed to diversifying the bank's asset portfolio, though, as we have noted on previous calls, interest rate spread widening is subordinate to prudent management of credit risk. Additionally, we believe it is likely that the yield curve will continue to steepen during the remaining of this year and into the next, enabling us to profitably reinvest in similar assets at higher yields. The effects of our spread-widening initiative will be noticeable in Q4. We believe that the Q3 spread of 133 basis points is the lowest figure that we will see, and we anticipate that spread will exceed 150 basis points in Q4.

Our spread target remains 200 basis points, and if our current expectations for the market hold, we believe that we will get there by the middle of next year. Achieving our spread target will more than offset a decline in income from our retail and correspondent mortgage channels, as we generate approximately $0.01 in earnings for every 15 basis points improvement in net interest spread. Increasing our spread from 133 basis points to 200 basis points will add over $0.04 per quarter to our bottom line.

As the economic environment changes, we are shifting the focus of our lending business. In Q4 and into next year, we will emphasize consumer finance loans and purchase money mortgages. In the consumer finance area, we have continued to see steady growth. We have seen strong results from Ganis Credit Corp., our Marine and RV loan originator. During the quarter, we announced a private label financing program with Genmar Holdings, the world's largest builder of recreational boats, to be the exclusive preferred provider for Genmar's dealer base.

We are expanding our purchase money mortgage business by striking strategic alliances with leaders in the industry. During this past quarter, we signed a strategic marketing alliance with Owners.com, the nation's largest provider of real estate services for the independent home seller, and NextJump, an industry leader in corporate perk discount programs for Fortune 500 companies.

At the same time, we have made operational changes to accommodate our shift in lending focus. During the quarter, we reduced headcount at our retail mortgage facility by nearly 40% from second quarter highs, primarily through the elimination of temporary employees. At the same time, we have added staff to our consumer finance areas. Over the past 3 years, we have prudently grown the infrastructure of the bank to support new products and lines of business. Now we are leveraging that infrastructure. During the quarter, we down-streamed $60 million in capital to the bank. We anticipate that this capital will generate incremental returns of greater than 20%. The bank's operations are highly scalable and can accommodate additional assets and deposits with minimum incremental costs. Accordingly, during the remainder of this year and into the next, we will look for other opportunities to grow the bank's balance sheet.

Finally during the quarter, other banking-related revenue increased $3 million, as we continued to improve recurring fee income from the management of our collateralized debt obligation offerings, credit cards and other non-interest related sources of revenue. We anticipate that these line items will continue to grow, which will also help to defray the impact of the mortgage slowdown.

At the beginning of this year, we spoke of 3 areas that distracted from our core business. These areas were: underutilized facilities, unnecessary products and under-performing investments; pending litigation; and issues surrounding corporate governance. As we as a management team move to the conclusion of 2003, I am pleased with the progress that we have made in each of these areas, as it allows us to better focus our attention on building the business. In the first quarter, we took a hard look at all parts of our operations and made tough choices. Now I am proud to report that we have substantially completed the restructuring initiative that we began in Q2.

In the third quarter, we booked $47 million in restructuring charges and exit activity, of which $41 million was associated with our 2003 restructuring initiatives and the remaining $6 million represented the residual from our 2001 restructuring plan and other exit activity. As a result, our total restructuring and exit-related charge from our 2003 plan, spread over the past 2 quarters, was $111 million, $9 million under our original $120 million target. We believe that we have incurred nearly all costs anticipated by our 2003 restructuring plan. Any remaining charges from this point forward will be immaterial. Through these and additional steps, we are positioned to realize our projected $47 million in annual savings. These savings translate into approximately $0.02 in total quarterly savings, or just over $0.08 per year compared to Q1 03 expense levels. We have also thoroughly examined our corporate equity investment positions, and where appropriate, made modifications.

As I said earlier, we realized a $41 million net gain on a strategic sale of $65 million of our stake in Softbank Investment Corporation, or SBI, this past quarter. We redeployed $60 million of this cash into the bank to fund recurring growth opportunities. The fair market value of our remaining 14% ownership in SBI as of September 30th, based on yesterday's closing price on the Tokyo stock exchange, is over $255 million against a book basis of $59 million. We will clearly continue to carefully evaluate and optimize our capital allocation and make further modifications as necessary.

We have also worked hard to resolve outstanding litigation-related issues. With respect to the MJK-related litigation, we announced last quarter that we had resolved one of the most significant matters and took a $7 million reserve. We continue to believe that this reserve is very appropriate in light of any remaining exposure.

And as I stated a few minutes ago, this past quarter, we settled outstanding employment-related claims at E*TRADE Mortgage for $6 million. Both the MJK and this Arroyo litigation relate to issues dating back as far as 1998. While litigation is a fact of life, these 2 matters were our most significant outstanding items. There is currently no litigation that we believe would have this kind of impact going forward.

We have also worked hard to become a leader in corporate governance, and we're gratified to see our efforts discussed prominently in the Wall Street Journal and on television. Our efforts to provide greater transparency have also been well received. As we promised in our last quarterly conference call, we began providing monthly reports on key business drivers in August. We continuously seek new ways to simplify our reporting methods.

To that end, we remain committed to our transition to natural account expense reporting beginning in 2004. In addition, I am pleased to announce that beginning in the first quarter of 2004, we will report all results on a GAAP basis, eliminating our pro forma ongoing EPS calculation. Furthermore, we intend to provide 2004 earnings guidance in December along with our monthly metrics report.

In keeping with our promise of improved corporate communications, we will host our second annual analyst day beginning Thursday evening through Friday afternoon, February 19th and 20th. More details about this event will be available from our Investor Relations group. As I said last quarter, we believe that we are building a great company, and we believe that increased transparency will serve to validate our strategy and direction. Now to Len.

Leonard Purkis, Chief Financial Officer

Thanks, Mitch. We ended the third quarter with cash and equivalents totaling $990 million. Free cash totaled $530 million this quarter, which is a $78 million increase over the prior quarter. This increase is net of $33 million associated with the exit of a lease obligation on office space on Townsend Street in San Francisco, and $60 million downstream to the bank. Free cash as we define it represents cash held at the parent and excess regulatory capital at bank of brokerage, a metric used by management in measuring business performance.

At the bank, net charge-offs fell to $6.8 million this quarter; it's down from $7 million last quarter. Overall net charge-offs as a percent of average held for investment loans declined from 49 basis points last quarter to 44 basis points. Despite the declining net charge-offs compared to last quarter, we again increased our allowance for loan losses slightly in the third quarter to $34 million versus $32.7 million in the second quarter, as we continue to provision in excess of our net charge-offs. Our reserves now represent 162% of total non-performing loans, and that's up from 75% a year ago.

Our commitment to strong credit is manifest in the credit quality of our borrowers as measured by weighted average FICO score above 730 for a total loan portfolio as well as for our consumer and mortgage portfolios. Our bank also remains well capitalized, as defined by the Office of Thrift Supervision, with Tier 1 and risk-based capital ratios of 6.61% and 12.5% compared to 5.94% and 11.8% respectively at the end of our second quarter.

Moving now to our P&L, total net revenues for our third quarter totaled $398 million, a 4% improvement over last quarter and a 21% improvement over the same quarter last year. The increasing revenues quarter-over-quarter resulted primarily from growth in our brokerage operations. Brokerage revenue for the quarter totaled $238 million, a 7% increase from last quarter and a 14% increase from same quarter last year. Net banking revenue for the second quarter – for the third quarter totaled $160 million, up 1% from last quarter and up 33% over the same quarter last year. Gain on sale of loans generated from our correspondent mortgage business and gain on sale of other securities remained strong over the quarter, increasing 55% from last quarter, helping to offset the 14% decline in gain on sale of originated loans from our direct consumer lending business.

Looking ahead, we anticipate that the slowdown in mortgage volume will not impact the correspondent channel as significantly as the retail channel. The marginal decline in net interest income comes as a result of accelerated prepayments in our mortgage portfolio, reducing our net interest spread over the quarter. Of the 11 basis point net decline in bank spread this quarter, 6 basis points was due to prepayments, 3 basis points was associated with accounting changes from FAS 150, and 2 basis points was due to increased low-yielding cash balances in preparation for the implementation of our sweep product late in the quarter. Our gross margin improved to 61% this quarter. That's up from 58% in the prior quarter, driven by a 3% reduction in cost of services. In addition, operating margin from ongoing operations improved to 28% from 24% in the prior quarter. In selling and marketing expense, we saw a 7% decrease quarter-over-quarter, and G&A increased 9% from the prior quarter, due primarily to employee bonus accruals.

In summary, the company reported third quarter net income of $61 million, or GAAP earnings per share of $0.17. Net income from ongoing operations totaled $63 million, or $0.17 per share, which is up from the $0.14 per share in the second quarter of '03. Reconciliation of the $0.03 quarter-to-quarter sequential increase to earnings per share from ongoing operations is as follows. Brokerage earnings were up $0.04 per share over the previous quarter. Total DARTs increased 13% this quarter, driving increased earnings of $0.02.

Additionally, we gained an incremental $0.005 from increased margin debt balances and an additional $0.015 from restructuring. Bank earnings declined by $0.01 per share during the quarter. This $0.01 decline was the result of a $0.01 loss associated with the E*TRADE Mortgage-related litigation settlement, another $0.01 loss from spread decline, offset by a $0.01 increase from recurring fee revenue. Thus the incremental contribution from banking and brokerage was a sequential $0.03 per share increase in third quarter results.

Turning to our guidance, in light of current activity levels, the full realization of restructuring benefits and the implementation of the sweep deposit account program, we are raising our 2003 guidance for both GAAP and ongoing results. Based on our third quarter GAAP results and our expectation for continued business strength, we are raising the range for 2003 GAAP results from between $0.22 and $0.27 to between $0.40 and $0.48. In addition, we are raising and narrowing the range for expected 2003 earnings from ongoing operations to between $0.56 and $0.58 from our previous range of $0.52 to $0.57; that's implying $0.16 to $0.18 from ongoing operations for the fourth quarter.

Reconciliation of third quarter to fourth quarter results is as follows. We estimate the third quarter at $0.17 from ongoing operations. Backing out the $0.01 per share cost associated with E*TRADE Mortgage litigation, we exited at a $0.18 run rate. In the fourth quarter, it's possible that we could lose up to $0.035 to $0.04 from our mortgage businesses, which would represent approximately 70% of current profitability in this area. We expect to gain approximately $0.01 to $0.015 from core banking activities, which include increased net interest spread, a larger balance sheet and increased non-interest income from non-mortgage sources. We also believe that our brokerage results will improve $0.01 to $0.02, principally through higher DART volumes and higher average margin debt balances.

So in total, we expect fourth quarter earnings to come in approximately in line with third quarter results. When we look to the fourth quarter, there's another opportunity to demonstrate the strength of E*TRADE Financial's model and the company's ability to deliver strong results in varying economic conditions. With that, we now open the call up to answer your questions.

QUESTION AND ANSWER SECTION

Operator: Our first question is coming from Mike Vinciquerra of Raymond James.

<Q – Michael Vinciquerra>: Thank you. Good afternoon, guys. My questions, really I want to focus on the accounts. I've got several here, but I just want to focus on that for now. Accounts at the – overall accounts you had, inactive accounts of 128,000 in the quarter, and I know you define that now as $25 or less in balances. What exactly is going on? And that seems like an awful large number of accounts in one quarter to drop below, and I would guess if you don't have a maintenance fee to get the accounts below $25, people are withdrawing their money for some reason, via check or some other method. Can you help us out with that a little bit?

<A>: I'm happy to tackle that and if Lou wants to tackle that it's fine. You're right, you will you not see this is recurring. To be quite direct, as we defined inactivity last quarter, we did not apply it thoroughly and accurately to our BSG business, and as we went back and evaluated our Business Solutions Group, we took a significant one-time definition here of inactive in relationship to that. As well,you may know that one of the things that we bought in the acquisition of Ganis was a keyboard business, Keyboard Acceptance. It came with accounts. We sold that business last quarter. So the combination of those 2 things are what are driving the significant inactive number, and you would not see that on a recurring basis.

<Q – Michael Vinciquerra>: Okay. And I thought Lou was going to say something. But secondly, on the total account side, I'm just trying to get a feel for – you mentioned, I think, that average trades per account per year was now like 11.8, it's up substantially, but before – I don't know – I want to know if the professional traders were included in that, and my guess is that your professional trading organization probably has less than a thousand accounts. I'm just guessing completely because you guys have never really talked about it. Can you give us some idea where that is, and where would your trades per account be without the professional trading cycle, because that obviously you had a very nice sequential increase? Thank you.

<A>: The professional trading is in there, and what we can do is, offline, if you want, we can try to drill you down through the exact percentages. It's only since been – obviously since the first of the year since we've been measuring this. So we'll come back to you on that with more specifics.

<Q – Michael Vinciquerra>: Okay.

Operator: Thank you. Our next question is coming from Colin Clark of Merrill Lynch.

<Q – Colin Clark>: Hi. Good afternoon.

<A>: Hey, Colin.

<Q – Colin Clark>: Hey. I was hoping you could just break out, of the $0.08 this quarter, how much on the bank side came from spread income and from mortgages? And also if you could maybe provide a little insight on – in terms of quantifying the sweep accounts and how that translates into your increased spread, or what's the contribution from the sweep?

<A>: Yeah, happy. Let me start and then turn it over to Arlen. So basically as you know, we made $0.08 in the banking operation. Approximately $0.04 of that was in core banking and the other $0.04 was in our correspondent and retail mortgage businesses. The truth is that if you add back the $0.01 that we had to pay in connection with the litigation settlement on an ongoing basis, the 2 mortgage businesses together would have made $0.05 of the $0.09. As we guided for Q4, to be very clear, as Len said, we assume that we would lose approximately $0.035 of that $0.05, which assumes that we lose about 70% of the profitability in Q4 from our mortgage operations. So hopefully that sort of answers the question you were getting to.

<Q – Colin Clark>: Okay. And the – in terms of the sweep accounts and the impact on spreads?

<A>: Yeah, let me start and then I'll turn it over to Arlen. The way in which we're looking at the sweep, and let me be clear in terms of its components. The first thing is that we are, tactically, immediately paying down our wholesale borrowings, and one of the issues is, when you look at our cost of wholesale borrowings, it is – those are the borrowings which are fully ladened with the hedging costs. So if you looked at an overall run rate of about 2% for our cost of funds from wholesale borrowings, you assume that you are replacing that with 15 basis points cost of funds, you pick up somewhere around 185 basis points. On the 185 basis points, it's important to note that the company as a whole was already receiving around 85 basis points in the form of brokerage revenue for this, so net to E*TRADE Financial as a company, there's probably 100 basis points of pick up, and that 100 basis points translates to somewhere in the neighborhood of $0.015 to $0.02 annually per $1 billion of sweep that's moved over, and there's $7 billion worth of sweep that's capable of being moved over. Arlen, you want to add on?

<A – Arlen Gelbard>: You know, at this point, you know we moved over $2.7 billion in Q3, and it really was right at the – or $2.8 billion, I'm sorry -- and it was right at the end of September, so the effect on Q3 was negligible. So we'll be able to feel the full effect of the $2.8 billion in Q4, as well as our current plans to move over an additional $1.3 billion late in Q4. Again, you won't get a full quarter run rate for that, but overall, if you're looking at that together, you know, we're talking about the effect of moving over $4.1 billion. As you look forward into the future, we have also made the sweep the default option so there will be a natural flow into the sweep account, so that will naturally grow, and there are other aspects, as Mitch said, there are other sweep funds that are still being held, that we are looking into the possibility of moving over. The sweep that we have, by the way, I mean, just so people understand, is really just a pretty typical sweep product that's offered by a number of brokers, but it's something that we talked about since the beginning of time when we announced the merger of E*TRADE and Telebank, and it is something that we feel was really important as we look to deepen and expand the integration of the bank and broker and increase the relationship with our customers. So ongoing, you know, as Mitch said, you know, the run rate would be $0.015 to $0.02, you know, per billion, and, you know, in Q4, we would expect to see $0.01 to $0.015 on the amount that's moved over.

<Q – Colin Clark>: Okay, great. And the additional $3 billion, is it reasonable to assume that that does get moved over at some point in 2004?

<A>: I think it's a great question and I think it's fair to assume that as we give guidance for 2004 in December, we'll address that exact question.

<Q – Colin Clark>: Okay, thanks. I'll hop back in queue.

<A>: Sure.

Operator: Thank you. Our next question is coming from Richard Repetto of Putnam Lovell.

<Q – Richard Repetto>: Yeah. Hi, guys.

<A>: Hi, Rich.

<Q – Richard Repetto>: First, I guess an accounting question here. On the G&A, it looks like it went up about $6 million quarter-to-quarter, and I know you talked about bonus accruals, but there also bonus accruals – I wonder if you can go into the bonus accruals, because I think – I thought you had taken them, or a certain level, last quarter as well?

<A>: We did, and predominantly the $6 million is driven by bonus accruals, and it's for the overall base of employees. We continue to outperform this quarter, and since, as you know, we've established bonus plans that are now really performance-driven, the accrual will vary based on performance and one of the things I'm not willing to do is back it out.

<Q – Richard Repetto>: Okay. So I guess, I just what you're saying, that you're not going to give us the total absolute dollar amount of bonus accruals for the quarter?

<A>: I know, I'm happy to give it to you if you want. Total bonus accrual to date for the company as a whole is about $40 million.

<Q – Richard Repetto>: Okay. And I guess the second question, the follow-up is, you know, Fidelity came out with this $8 big splash offering. I know there's some different restraints to it as far as fees on – $0.01 per share above $1000, but I guess the question is, you know what are you seeing so far, Mitch or Jarrett or Lou, in regards to impact of Fidelity's offering, if any, on your Power of 9 program?

<A>: Mr. Klobuchar's got it.

<A>: We look at that obviously pretty closely. We monitored all aspects of their new offer, and compared it to ours. First of all, from the standpoint of the offer itself, and Fidelity is a place for active traders, we really don't come up against them much in that space. Obviously they've come on to something that we realized a year or a year and a half ago, which is that active trader space is the space to be, so I think their new offer intends to try and make them competitive in a place that we already recognized was a growing niche in the business. Having said that, again, active traders don't really look to them as a place to trade, so we've monitored the transfer of accounts for the 3 or so weeks since their offer, and we can count our active trader transfers to Fidelity on one hand.

<Q – Richard Repetto>: Okay. I'll get back in the queue. Thanks.

Operator: Thank you. Our next question is coming from Min Sohn of Janus.

<Q – Min Sohn>: I'm sorry. I didn't have a question.

<A>: Hey, Min.

Operator: We'll move on to our next question, which is coming from Charlotte Chamberlain of Jefferies.

<Q – Charlotte Chamberlain>: Hi, guys. Congratulations on a fine quarter. I was just wondering if you could give us some metrics on September, June and last year, of the consumer finance assets, and basically what got sold and what got kept, and some color on what your gain on – as I understand it, you keep some and you sell some, and I was wondering if you could kind of give us some color on gain on sale for the consumer loans versus the mortgages? Thank you.

<A>: Happy to do it. So let me – I don't know if I'm answering your question correctly, so let me just try to take a crack at this in terms of what you're getting at. On balance sheet, there's obviously the difference between originated at Ganis and what we put on balance sheet and what we don't put on balance sheet. Balance sheet for consumer finance assets is approximately $4 billion as of the end of this quarter. It stayed pretty consistent over the last 3 or 4 quarters. It's about $2 billion in auto, and about $2 billion in Boat and RV, of which, as you know, the RV is 85% or 90%, it really drives a significant piece of it. So – and that hasn't changed; if you've looked at the charge offs over the last 3 or 4 quarters, they've been pretty consistent and down and below model. So that's sort of touching on the balance sheet. In terms of Ganis and the origination, you saw the origination this quarter pretty consistent with last quarter, up maybe $100,000 or $200,000, sort of in that range. What we have seen was that last quarter again, like almost every quarter, rather than selling for a gain on sale, we retained almost all of the origination and put on balance sheet. You've seen us retain somewhere between 85% and 90% to put on balance sheet to widen spreads, so when you look at the gain on sale number in connection with Ganis that shows up, it is an immaterial number. It is, you know, in the $1 million range as a percentage of the total.

<Q – Charlotte Chamberlain>: Okay, then what was the gain on – what was, in basis points, the gain on sale from mortgages then this quarter versus last quarter?

<A>: Let me get back to you on it because I just don't track it that way.

<Q – Charlotte Chamberlain>: Okay. And you did – I'm sorry, you did 200 – how much total did you do in originations in Boat and RV and autos this quarter? I guess I missed that on your sheet.

<A>: It's on the sheet that's up on the website, so you'll be able to see it…

<Q – Charlotte Chamberlain>: Oh, it's on the website.

<A>: Yes, it's also on the metrics. It's right there.

<Q – Charlotte Chamberlain>: Okay. Thank you.

<A>: Okay.

Operator: Thank you.

<A>: Arlen is telling me Ganis is about $500 million.

Operator: Thank you. Our next question is a follow-up from Michael Vinciquerra of Raymond James.

<Q – Michael Vinciquerra>: Thank you. Actually I just wanted to follow up on the question regarding the sweep accounts because I'm a little confused at the numbers that you gave, so bear with me, if you could. My one question is just on the cost of funds on the FHLB advances on your balance sheet, it shows something like 5.6%, and you said that included the cost of the hedging. Why would that be considered a cost in your cost of funds? You're backing it out to get down to 2%, but you won't need to hedge the sweep account money because it's locked at 15 basis points or wherever you set it, I would assume. Why do you back it out and not go from 5.6 instead of 2%?

<A>: Well, I would say you're right conceptually, which is sort of the $0.015 to $0.02 that we're giving you guidance on, so that what we need to do, as you well know, is go through go through this, look at the duration as we put them on balance sheet, feel comfortable that you're correct in terms of the duration match and that we can totally disconnect the hedging. What we are assuming here is that it's the same basic notional amount of hedges that we keep on balance sheet, so there's upside in the numbers to your question.

<Q – Michael Vinciquerra>: Okay. Then just a second thing there, you talk about the 85 basis points you were earning at the brokerage in terms of your money market fees. Weren't you actually paying out, though, to your customers something like 1% and then you were netting out 85 basis points and you're actually paying them on a net basis, say 10 to 15 basis points, so that we're talking about apples and oranges a little bit there?

<A>: No, because we were actually paying – the actual net to us in terms of profit from that account was about 85 basis points. So if you looked at what we received and what we were paying out to our customers was only about 6 basis points. 9 basis points -- I stand corrected.

<Q – Michael Vinciquerra>: Okay

<A>: Okay. So in other words, if you think about a typical sweep account and what you might get paid for it, it could be in the range of up to 100 basis points or less, 95 to 100. If you back out what you're paying to your customers, which for us was 9 basis points, that will get you to – and I can tell you with certainty that brokerage was receiving, net, about 85 basis points in profit on it. And if you have any specific questions, you should feel free to call Arlen and he can walk you through the specifics, but I can tell you with certainty that, you know, $4 billion, assuming that we move over the next tranche by the end, will generate for us on an annualized basis somewhere between $0.05 to $0.08 of additional earnings, and frankly, as you well know, if you doubled it from $0.04 to $0.08 or $0.07, it could, you know, be in the 10 to 16 billion – I mean $0.10 to $0.16 range.

<Q – Michael Vinciquerra>: Okay. All right. One separate question if I could shift gears a little bit, just on your average commission obviously dropping, and I sense it's because the professional trading picked up at a faster pace than the rest of the business overall. Is that what we're looking at, and how low do you think that the commission will go, given that your core $9.99 offer only fits presumably 50%, 60% a year, of your client base?

<A>: Yes, its great point. So let me have Lou answer that for you.

<A – Leonard Purkis>: Okay. First of all, yes, we did drop about – well, $0.64 from the prior quarter in average commission. We've seen that fluctuate a bit. If you've gone back to Q1, you would see that back then, it had actually gone up $0.16 to $11.67 from $11.51. So these things fluctuate for a couple reasons. You put your finger on one of them, and that was in this quarter, you saw a greater shift to the professional volume, which of course is included in that total calculation. That was actually responsible for about $0.24 of the $0.64 shift. The balance of it was a function of shifts, and we see some flows on this quarter to quarter, but it was a shift from the amount of business done by Power 9 customer versus the Main Street customer, and now some of that is not Power of 9 type active trader customers doing more. Some of that is also Main Street customers who were trading 5 or 6 or 7 times a month, trading a little bit more actively, so they actually redefined themselves in a new category. But we see that ebb and flow. You know, regarding the bottom, we're not going to, I think, predict that because it is a function of the mix of business and it changes quarter to quarter. You do know that $9.99 is the low point in our rates, and obviously we still have a lot of Main Street customers, so I would hope not to see it drop, you know, very significantly, almost regardless of circumstances. Hey, one other thing I'd like to do is double back to the question you asked earlier, Mike, because we did just a couple of quick calculations here with metrics that were provided to you so you can refer back to them. You had spoken about the annualized revenue trades per account in the script going up to 11.8 from 6.6, which is a 79% increase, and you were curious about whether or not that was a function of the mix of business on professional traders and the number of accounts that they have. While that is true, what we just did was a calculation exempting out the professional traders, and just looking at US DARTs versus US accounts, on your metrics table, we compared September of last year to September of this year, and on that retail calculation, you'll actually see that uptick was pretty close to the same thing. Instead of 79%, it was actually up 82%. So I can gladly take you through the numbers we use in that calculation, but whether you look at it purely on the basis of retail or combined, we saw an uptick of about that amount. Also, I think you asked the question about how many people are involved in the E*TRADE pro space, and it is true that that's 1000 accounts or less, but obviously the answer that I just gave you where we looked at just retail factors all that out.

<Q – Michael Vinciquerra>: Thanks a lot, very much for that, Lou.

<A – Lou>: Yes.

Operator: Thank you. Our next question is coming from Justin Hughes of Jefferies.

<Q – Justin Hughes>: Hi. Congratulations on the quarter again. I wanted to just follow up a little bit on the G&A number. Something we haven't talked a lot about is there was a $7 million charge last quarter for MJK, so if I kind of take that out of the G&A number and then take out the litigation – the $6 million litigation charge this quarter, we still get about a $7 million increase quarter to quarter, and also I was kind of expecting some savings from the restructuring you did last quarter and this quarter. Was there some type of shift at all between G&A and maybe cost of goods sold because that number was so much lower…

<A>: Yes.

<Q – Justin Hughes>: …or is it purely bonuses that are accounting for the sequential increase?

<A>: No, it was. So in other words, it is entirely bonuses. We have footed the number, and the predominant savings that you are seeing are showing up in our cost of services going down by the $6 million.

<Q – Justin Hughes>: Okay.

<A>: So you're seeing a lot of the restructuring going through cost of services.

<Q – Justin Hughes>: Okay. And then just one more question if I could on the sweep accounts. Do the customers have to sign up for that, and if they do, or how are you marketing that?

<A>: Let me actually finish one thing because the 2 areas you'll see it in terms of the restructuring savings are cost of services and the other one that is important is you also saw a sequential decline in marketing. Marketing was down in acquisition, but there was also a bigger number in sales and marketing, and a lot of that is the benefit which used to roll through as a marketing expense in connection with the centers, which we have now shut down, particularly New York.

<Q – Justin Hughes>: Okay. That makes sense.

<A>: And Target (NYSE: TGT).

<Q – Justin Hughes>: Okay.

<A>: Okay. I'm sorry, what was the question, Justin?

<Q – Justin Hughes>: On the sweep accounts, do customers have to sign up for that or can you just do it without them knowing?

<A>: No, you can – let me be really clear. You can do it without them knowing because if you look at the customer agreement, it is negative consent. So you can automatically move them over. We have made the decision that for the first 2.7 or 2.8 that we referenced here, those were brokerage customers between a $5,000 balance and a $100,000 balance, and we moved it over through negative consent and, in fact, we've lost no one and gained net about $100 million throughout the – through the last 2 weeks of the quarter. If you back up and look at the next 1.3 that we're talking about, which is why I think Arlen was referencing it, could take as long as – and not occur until the end of Q4, although we have the ability to negative consent, it's over $100,000, and to the extent that we only have one bank charter, the FDIC insurance is limited to that $100,000. So we want to actually ask for their positive consent.

<A>: But it can't be done without them knowing it, just to clarify.

<A>: Yeah, good point.

<A>: They get notified and they get an opportunity to opt out, and it is now the default, you know, option, but clearly they do know about it and they have a chance to opt out.

<A>: And it's not a one-time chance opt-out. They can change whenever they like.

<Q – Justin Hughes>: Okay.

<A>: It's completely up to them. When you're signing new accounts, even though we keep referring to it as the default option, it is still something that you also have a list of other options. It's just if you choose none, that's where you'll go.

<A>: And the only, the hair splitting here is that they don't have to opt into it, they have an option to opt out.

<Q – Justin Hughes>: Okay. But most importantly, you don't have to spend a dollar of marketing to do it?

<A>: That's correct.

<A>: Yes. Right.

<A>: Which is what I thought were you getting at.

<Q – Justin Hughes>: Okay. Thank you.

<A>: Okay.

Operator: Thank you. Our next question is a follow-up from Colin Clark of Merrill Lynch.

<Q – Colin Clark>: Hello. The gain on sale from loans held for sale was up significantly. I was wondering, I know you talked about it a little bit, I was hoping you could just talk about that, what's going on there a little bit more? And I'm assuming the run rate of $32 million for this quarter, you know, the run rate going forward would be lower with just the lower origination volume, lower mortgage volumes going forward. And related to that, you had commented that the refi slowdown will not impact your correspondent channel as much as your origination channel. I was hoping you could provide a little bit more commentary surrounding that comment?

<A>: Okay. I'm happy to. So let me begin by saying we are looking at our combined mortgage business, and you know that's how we look at it. So we look at those 2 line items as the compilation of retail and correspondent. So when we guided in Q4 and assumed that profitability would be down by 70%, we assume in the aggregate between those 2 businesses together we will lose 70% of the profitability in Q4 in connection with the guidance. The expectation is that you will be down – you could potentially be down more in your retail business. I think we're trying to be prudent, and you would hope to be down less in your correspondent, particularly because of the number of relationships you've built around flow, and what we saw. So as you saw the slowdown occur in retail mortgage pretty dramatically in September, you did not see that same slowdown in mortgage origination on the correspondent side. And in fact if you look at the individual segment reporting, what you will see is that we were actually up quarter-on-quarter in terms of production or origination in correspondent while we were down in retail. And fundamentally, what we simply did is we took advantage of, if you looked at the gain on sale in connection with the correspondent business in Q2, it was a lower number. We waited, we held more of the origination, packaged it and sold it along with the excess production in correspondent in Q3. Arlen, you want to follow up?

<A – Arlen Gelbard>: I think you said it just right. It really is that the retail was, will slow faster. The correspondent is something where we bulk up loans and then we resell them opportunistically. So it really is – you know, we can control the timing; we can control the aggregation when we actually get it out there.

<Q – Colin Clark>: Okay. And, but the type of loans that are being generated through the correspondent channel are similar, meaning a lot of it is refi, not – there's not a higher mix of purchase or other types of loans?

<A>: No. I think that the kinds of loans that you're getting through the correspondent channel are a bit more typical of the industry as a whole. So perhaps not as high as our retail channel, which was around 90%-plus in refi and I think it's much closer to around 65% to 70% refi. So you have a strong – you have a volume there as you know, the purchase volume is still remaining very strong in the industry. Purchase volumes even for our retail side have remained very strong and, in fact, are improving. On the correspondent side, though, we're buying from other lenders that aren't as refi heavy as we were in the refinance pool.

<Q – Colin Clark>: Okay, great. And just real quick, separately, the international trades were up strongly again relative to the mainstream US. Where is that coming from exactly? Is that primarily Japan?

<A>: No, in fact, it's not Japan at all. So let me turn it over to Lou and little more because he's the one who's executed and delivered on it.

<A – Leonard Purkis>: Yes, first of all, we have targeted over the last 6 months or so in the international space the exact same way, that we targeted a year and a half ago in the US space, and that was the active trader segment. And our technology group, over the course of the last year, has delivered customized platforms to those individual countries to support the needs of active traders in those locations, so we got the product out there and the active traders have started using it, particularly good when others have been exiting the space. In addition, we've rolled out products that were in demand by active traders that were unique to these individual countries. So for example, we roll out CFE's and Forex trading in a number of these international locations. I can tell you a little bit more specifically from Q3 to Q2, we have had some extreme bright spots in an overall very bright picture, up 24%. In Germany and Denmark, the run rates that we see on those numbers were actually more than twice that rate, so those were the brightest spots there, and then in some IB revenue, again in Denmark, we saw transaction volumes again more than double the 24% run rate.

<A>: And just to clarify something, the international trades come exclusively from our operations in Hong Kong, the UK, Sweden, Denmark and Germany.

<Q – Colin Clark>: Okay. Great. Thanks a lot.

<A>: Absolutely.

Operator: Thank you. Our next question is coming from Rich Repetto of Putnam Lovell.

<Q – Rich Repetto>: Hi, guys.

<A>: Hi Rich.

<Q – Rich Repetto>: If this can be done quickly, could you walk us through just how you get – you probably have this figured out already, but how you get the 133 to 150 in the last quarter on the spread?

<A>: Happy to do it. Arlen?

<A – Arlen Gelbard>: Yes, Hi, Rich. It really is coming from 2 key areas. One is asset diversification. We keep talking about it, we've been talking about it for the last 6 to 8 quarters, we've been executing on it, but as some people around here like to say, it's kind of like turning an ocean liner, so it's something that, you know, takes time, but is definitely improving. From that, we would expect, roughly, to get about 3 basis points out of that. The rest of it, quite frankly, is coming from the sweep product. It is really going to have a dramatic impact on reducing our cost of funds. As Mitch mentioned before and I mentioned before, it really will result in this quarter in about a 15 basis point pickup, so when you add the 2 of those together, you get 18, and that, at a high level, is the bridge from 133 to just over 150.

<Q – Rich Repetto>: Great. Thanks. That's all I have.

<A>: And Colin, I forgot Canada in those international trades as well.

Operator: Thank you. And our last question is coming from Jed Gore of Sunova Capital.

<Q – Jed Gore>: Hi, great quarter guys.

<A>: Thanks Jeff.

<Q – Jed Gore>: All my questions have been answered so I'll make up one up. The accretion of cash in the balance sheet has been impressive, and I guess we were just wondering if there is anything else you can do to improve your cost of funds besides the sweep account? I'm just looking at these convertible sub notes that you've got here, and just sort of anything to do with the cash to improve your cost of funds.

<A>: Yes, I mean, listen, we are in an unusual and enviable position as a company for the first time in our history, in that we are generating significant positive cash flow and have to begin to evaluate what's the highest and best use for the return on that cash. As we indicated on the call, we're in a position, you know, where we still own a significant, a 14% share in SBI, which is worth, net of the gain, still a couple of hundred million bucks, and we're going to continue to prudently review all of the assets on our balance sheet to make sure that we maximize them. As well, if you look at what we're simply generating in cash from our operating businesses, it's a pretty substantial number. So this past quarter, one of the things that we did was, we down-streamed $60 million of capital in the bank. We looked at, as Arlen said, the lowering the cost of funds. We looked at the sweep account really driving that, we looked at the shape of the yield curve and an asset class that we're always very comfortable with in mortgages and felt that, net-net, they were in excess of a 200 basis points spread, and so when you evaluate all of that, we feel confident in the ability to generate in excess of a 20% return on capital for that incremental capital being down-streamed. As you look at the brokerage business, it is not particularly a capital-intensive business. What would drive the need for capital for us would be, if we were fortunate enough to see our margin balances pop from $1.5 billion to $6 billion in the course of 40 days; otherwise it really is relatively self-funding. So we now have the ability to start to look at this cash generation and say, does it make sense to look at our convertible notes? Which, because of the implied improvement in our credit, the spreads tightened to a level where the both of them are trading at or in excess of par and are very expensive when you add a premium on to buy them back; you look at the stock in the marketplace and you also look at other ways in which we could use the capital in our core operating businesses.

<Q – Jed Gore>: Okay. I guess that means you're looking at it, which is great. And you're going to give guidance in the middle of December, I guess?

<A>: We will. When we send out our December monthly metrics, we will give full guidance with a walk-through in detail on how we get there, and it will be GAAP guidance.

<Q – Jed Gore>: That's great. Well, congratulations again.

<A>: Thanks a lot. Thanks a lot, everybody. We really appreciate it.

Operator: Thank you. This does conclude the third quarter 2003 conference call for E*TRADE Financial Corporation. Please disconnect your lines at this time and have a nice day.