MANAGEMENT DISCUSSION SECTION

Operator: Welcome to E*TRADE FINANCIAL Corporation's first quarter 2005 earnings conference call. At this time all participants have been placed on a listen-only mode. Following the presentation, the floor will be opened for questions. I have been asked to begin this call with the following safe harbor statement. During this conference call, the company will be sharing with you certain projections or other forward-looking statements regarding future events or its future performance. E*TRADE FINANCIAL cautions you that certain factors including risks and uncertainties referred to in the 10-Ks, 10-Qs and other reports it periodically files with the Securities and Exchange Commission could cause the company's actual results to differ materially from those indicated by its projections or forward-looking statements.

In this call, E*TRADE FINANCIAL will discuss some non-GAAP measures in talking about its performance. And you can find the reconciliation of those measures to GAAP in the company's press release which can be found on its website at www.etrade.com. This call is being recorded. The replay of this call will be available by telephone beginning at approximately 7:00 p.m. EST today to 11:00 p.m. EST on Wednesday, May 4th. The call is also being webcast at www.etrade.com. No other recordings or copies of this call are authorized or pay be relied upon. I will now turn the call over to Mitchell Caplan, the Chief Executive Officer of E*TRADE FINANCIAL Corporation, who is joined by Jarrett Lilien, President and Chief Operating Officer, and Robert Simmons, Chief Financial Officer. Mr. Caplan, you may begin.

Mitchell Caplan, Chief Executive Officer

Thanks everybody for joining us today; in 2004 we delivered record results by remaining focused and disciplined in the execution of our strategic plan. We leveraged technology to create operational efficiencies while enhancing our overall customer value proposition and positioning the company for growth. In the first quarter of 2005 we built on this success, delivering results that once again proved the power and flexibility of our integrated model. Through the multiple leverage points of our business and the benefits of integration within and between our core segments, we generated record quarterly revenue and consolidated operating income, and we achieved this amid an uneconomic environment.

I am pleased to announce that in the first quarter we increased total net revenue by 5% to $420 million while continuing to demonstrate prudent expense control throughout the business. We realized additional efficiencies through integration which drove reduced core operating expenses and record quarterly operating income of $135 million, an increase of 14% over a year ago. In addition we achieved these record results while increasing our investment in marketing as we outlined in our 2005 guidance. We have made significant progress over the year in reducing operating expenses and growing revenue while continuing to reinvest in the business. In doing this, we have driven top-line growth and increased our consolidated operating margin to 32% from 30% a year ago.

We have long talked about our value proposition being comprised of price, functionality and service. While price is and always will be an important component of value, it has become less of a differentiator across the sector as prices have moved into a narrower range. As a result, the ability to differentiate around the explicit price of a product has been significantly reduced. What we believe will allow us to win over the long term is our ability to differentiate through functionality and service while continuing to provide exceptional value through price. To that end, we launched E*TRADE Complete in late March, an innovative solution that provides complete integration across the customer's relationships with E*TRADE FINANCIAL. E*TRADE Complete represents the embodiment of our approach to integrated investing, trading, banking, and borrowing solutions with the unique cash and lending optimizers at the center. Through one account, our customers will have an entirely new way to manage and optimize all of their money with E*TRADE FINANCIAL. We are able to create this differentiated solution because we have the products and the technology platform on the front end with the business integration on the back end to deliver a compelling and highly valued solution. This combination creates a significant barrier to entry for our competition.

As we focus on building a long-term franchise, we put the customer at the center of all that we do. To be successful we must consistently deliver innovative products with the right service and functionality at an exceptional value that rewards customers for greater overall engagement with E*TRADE FINANCIAL. And to execute on this vision, we must manage, measure and report our business in a way that directly aligns our operations with our key customer segments. As previously announced, we have changed our segment reporting to retail and institutional rather than bank and brokerage in order to reflect our customer-centric approach. This view allows us to introduce new metrics that serve as proof points of our success. These metrics include total revenue per customer, total segment profit per customer and products per customer. In the first quarter, total revenue per customer increased 4% from a year ago, total segment profit per customer increased 13%, and products per customer increased 12% to just under 2 from 1.7.

As we continue to focus on the needs of the customer, we will further enhance our overall value proposition, drive greater product utilization and an improved customer experience, and by doing so, deliver greater long-term shareholder value. With that, I would like to turn the call over to Jarrett to discuss the details of our quarterly results and provide an update on some of our key initiatives for 2005.

Jarrett Lilien, President, Chief Operating Officer

Thanks, Mitch. As Mitch indicated earlier, we produced record results in the first quarter in an environment filled with weaker than expected retail trading activity, increased interest rate volatility, and overall economic uncertainty. We were able to grow revenue and earnings despite this macroeconomic environment as we continued to benefit from both revenue and expenses synergies across the business. Specifically, a core differentiator of our model is that we generated 80% of revenue from non-DART related sources as we leveraged relationships with our retail customers across investing, banking, lending and trading solutions while capitalizing on opportunities between our retail and institutional segments. Accordingly, we were able to deliver strong results in a soft trading environment while retaining significant leverage to a stronger one.

Focusing first on our retail segment, we generated revenue through our investing, trading, banking and lending relationships with our retail customers. These relationships drive essentially four sources of revenue, including net interest income, commissions, gain on loan originations, and lastly, fees. As we look at these sources of revenue, our model is again unique in that we have reached a place where the economics of cash are as compelling as the economics of retail trading. For instance, the economics of a customer holding $15,000 in cash, which we can sweep, is equivalent to a customer who trades five to six times a month. As a result, we are focusing on attracting and retaining high-quality accounts that bring with them a broader relationship around trading activity, lending, and cash management. This is an area where we plan to continue our investment in product development and marketing.

Based on the first quarter results, we are seeing further positive trends. We experience growth in our client deposits, offset by a decline in the value of security accounts and unexercised vested options from our corporate services business, adjusting for the market impact on the value of our customers' security holdings in the first quarter and looking at the flow of assets across all of our products, we experience net inflows of $2 billion. This is evidence that we are attracting high-value customers and driving growth in asset accumulation. In retail trading, activity held relatively flat with the prior quarter with total DARTs declining 1% sequentially and 14% from a year ago. Retail

DARTs declined 2% sequentially and 15% from a year ago, strengthened by international trading activity which increased 10% versus the prior quarter and fell a lower 4% versus a year ago. At over 10% of total DARTs and nearly 16% of all retail DARTs, our international operations have become an important contributor to our results and continue to represent one of our key differentiators from the competition. We believe our international presence represents a significant long-term growth opportunity and we will continue to make strategic investments in selected markets.

Average commission per trade in retail was $10.34 in the quarter. It was down from 10.89 in the fourth quarter. With our new commission structure now in place, we continue to expect our average commission per trade to move into our guidance range of $9.30 to $9.70 in the second quarter and for the remainder of the year. Around our lending relationships, margin debt continued to be a strong point for the retail segment in the first quarter. Average margin debt balances rose 7% from the prior quarter and 13% from a year ago to 2.24 billion.

Our institutional segment continues to produce strong results as we integrate our businesses and leverage the retail segment. On the integration front, we continue to make tremendous progress, rebranding all of our institutional trading businesses to E*TRADE capital markets. We are already seeing positive trends as we aggregate and report our company-wide execution volumes under one market identifier and clients realize that we represent 5% of the U.S. market across our listed and O.T.C. businesses. In addition we continue to benefit from our balance sheet integration across our retail and institutional segments. During the quarter we increased bank average earning interest assets by $500 million with the bank's net interest spread remaining flat with the fourth quarter at 220 basis points. This was the net result of a 14 basis point improvement in asset yields, offset by an equivalent increase in liability costs. This increase in liability costs was due to our decision to strengthen our competitive position in products such as money market, CDs, and sweep or SDA. This pricing action which offset the increase we experienced in asset yields was associated with a realignment of our pricing strategy throughout our entire suite of retail products in connection with our preparation to launch E*TRADE Complete. We changed pricing to get back in line in areas where we had otherwise been less competitive for some time; going forward, we will continue to reprice liabilities along with the industry as interest rates rise, and we expect that liability repricing will lag asset repricing, resulting in wider spreads in a rising rate environment.

In our assumptions for our 2005 earnings guidance, we said that we expected to deliver an average spread of 220 basis points to 233 basis points for the year. As we execute our 2005 plan, we see multiple opportunities to achieve our spread targets. Continued balance sheet integration represents a significant opportunity to drive spread widening. As we look at the total customer cash in investing and trading accounts, there was about $5.5 billion at the end of the first quarter. Of this amount, approximately 3.5 billion is available for sweep. If, for example, we are able to grow the sweep or SDA account by approximately $2.5 billion through the combination of actively swept cash and organic growth of existing balances, this represents a potential opportunity of approximately 25 basis points in increased spread. Also, we see an opportunity for another 10 to 12 basis points of spread widening as we execute on our initiative to move E*TRADE Clearing under the bank and continue to reposition the bank's balance sheet. In repositioning the bank's balance sheet we will continue to sell mortgage-backed securities and replace those assets with mortgage whole loans, HELOCs, and related retail lending products in connection with E*TRADE Complete, all while maintaining our strict discipline around credit quality.

In addition, we are now generating a risk-adjusted return at a level where we are comfortable growing the bank's balance sheet and we expect to do so throughout the year, consistent with our guidance. It is difficult to pinpoint the exact timing of these opportunities, but we expect many of them to be realized throughout the second half of the year. As a partial offset to these spread widening opportunities, we will continue to make investments in our value proposition. For example, based on our strategic initiatives for the remainder of the year including the full rollout of E*TRADE Complete and the creation of additional bundled price offerings, we expect that there will be some spread compression associated with delivering enhanced value to customers. Against the combined opportunities of about 35 to 37 basis points that I just outlined, we expect approximately 10 to 12 basis points of spread compression due to some cannibalization as we deploy E*TRADE Complete and customers become more optimized around their cash and lending solutions. We are prepared for this expected cannibalization, and it is a part of our guidance for spread assumptions and for earnings for the year.

Clearly organic asset growth from new and existing customers through our overall asset gathering strategy will serve to offset these risks and provide additional upside. As I previously stated, while we don't know the specific timing on when each of these opportunities will be realized, the fact that we have multiple ways by which to drive wider spreads allows us to remain comfortable with our guidance assumption of an average spread of 220 to 233 basis points for the full year. With that, I will turn the call over to Rob for the financial details.

Robert Simmons, Chief Financial Officer

Okay. Thanks, Jarrett. With today's earnings announcement being the first in our new revenue and segment format, I would like to take a minute to review the changes. On the face of the consolidated P&L, we have created a new revenue structure designed to simplify our results and help focus on the key drivers of our business. At the segment level, we have moved to retail and institutional to better track our core customer segments and reflect how we are running the business. In our new consolidated revenue format, we are now showing total company revenue in an integrated view rather than split by bank and brokerage. The commissions line item now includes the commission-based portion of our global execution and settlement business as well as commission revenue generated by our retail customers. Commission revenue from our institutional execution and settlement business was previously reported within principal transactions. Note that this is also a change from the draft version of the new reporting structure that we provided publicly at our analyst day in late February.

Moving down the P&L, we are now reporting gain related revenue on one consolidated line versus two separate line items in the former structure. To add additional transparency, we are now breaking out service charges and fees as a separate line. These revenues were formally reported within other under each of the separate bank and brokerage portions of the old structure. Lastly, we are reporting total interest income and expense on a consolidated basis, combining interest income from margin loans previously reported as brokerage revenue and interest income generated from the bank balance sheet. You can see the retail and institutional splits of all the line items in the segment schedule in our press release.

Retail segment revenue as now reported is revenue that we generate through our retail customer activity around trading, investing, banking and lending. This segment also includes results from our corporate services business as we are ultimately servicing our retail customers through these corporate relationships. The institutional segment reflects the results of our bank balance sheet management activities and our equity capital markets business including market making and institutional brokerage services.

With that explanation, I would like to highlight a few takeaways from the actual results of the quarter. The record quarterly revenue and segment income illustrate the strength and benefits of our integrated model. We were able to generate 5% year-over-year top line growth while DART volumes fell 14% year-over-year and average commission per trade declined 10%. Retail commissions represented 20% of total net revenue this quarter, down from 28% a year ago and 23% last quarter. Continued balance sheet growth, higher margin debt balances and improved spreads generated a 39% increase in net interest income year-over-year, more than offsetting the decline in retail trading related commissions. Service and fee related revenue was also up 34% year-over-year. We were able to capitalize on the growth in revenue in the quarter and widen our consolidated operating margin through prudent expense control and reduced restructuring related charges while adhering to our marketing investment strategy. Total operating expenses declined to $285 million from $299 million in the prior quarter while increasing by just $3 million from the year ago period. As planned, we increased our quarter over quarter advertising and marketing development spend by $10.2 million to $26.8 million as part of our 2005 marketing investment initiative. As we've said, we expect to continue to invest in marketing throughout 2005 as we roll out our new add campaign and promote E*TRADE Complete, but we will maintain a prudent level of flexibility.

If we look at total operating expenses in the first quarter versus the fourth quarter and exclude marketing and restructuring charges, we can more clearly identify the efficiencies we are realizing in our core operations. Total operating expenses excluding these two items declined $7.4 million compared to the fourth quarter. Most importantly, less than a million dollars of this decline was attributable to lower variable expenses associated with the decline in trading volumes. About 3 1/2 million was due to lower depreciation and amortization expenses which we expect to continue to decline over time. The remaining $4 million decline in total expenses was due to lower communications, occupancy and equipment, professional services, and other expenses, all the result of our focus on efficiency and integration. We expect to continue to make progress in reducing our total operating expenses.

On the bottom line we delivered $0.24 in GAAP earnings and $0.23 at the segment level during the first quarter. This was flat with the prior quarter on a GAAP basis and up $0.02 at the segment level. We achieved these earnings despite lower below the line income from a slower pace of selling our SBI holdings and the impact of an expected higher tax rate. In the first quarter, we generated enough SBI related gains to contribute a net $0.01 of non-segment corporate earnings per share, consistent with our guidance, compared to $0.03 in each of the prior quarters. As a result, a greater share of our reported EPS in the first quarter was from our core operations. In addition we returned to our forecasted tax rate of 36% in the first quarter compared to a 27% rate in the fourth quarter.

Regarding our open buy back program, we continue to see significant value in repurchasing stock at this time and expect to remain active in the near term. In the first quarter we repurchased nearly 2.5 million shares for approximately $33 million. We exited the quarter with $205 million remaining in our program for further debt requirement for stock repurchases.

As for our 2005 guidance, we are maintaining our estimated EPS range of $0.93 to $1.08 including the assumption that we will be begin expensing options in the third quarter. This guidance continues to assume a $0.01 per quarter non-segment corporate contribution from realized gains on investments predominantly related to SBI, net of corporate interests. Excluding the non-segment contributions, we are expected segment EPS in 2005 of between $0.89 and $1.04 compared to segment earnings of $0.80 in 2004. This implies earnings growth of 11% at the low end of our range and 30% at the high end. We continue to expect operating margin for the year of between 33% and 35%, with our first quarter results putting us well on track to achieve this the target. In closing, I would like to say that we are off to a great start in 2005 and we look forward to building on this success throughout the rest of the year. With that, I would like to open the call to questions.

QUESTION AND ANSWER SECTION

Operator: At this time, ladies and gentlemen, I would like to remind everyone, if you would like to ask a question, please press star followed by the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Your first question comes from Scott Patrick with Morgan Stanley.

<Q – Scott Patrick>: Hi, how are you guys?

<A – Mitchell Caplan>: Hey Scott.

<Q – Scott Patrick>: First question is just, obviously there has been a lot of talk about potential for accelerating consolidation in the industry and would like to get your thoughts on that.

<A – Mitchell Caplan>: Absolutely. So clearly when you look at the industry, it is ripe for consolidation. You are in a place where we are all in the financial services sector. Products are becoming increasingly commoditized and operating margins continued to widen because we create efficiencies. The so the good news for each of our P&Ls as you saw particularly with respect to us this past quarter is we were able to widen our operating margin, we were able to drive greater revenue regardless of the DART volume, and we were able to increase profitability. That said, you recognize that if you put two companies together that are doing the same thing, you can generate significant expense synergies. Also to the extent that you have our platform, by way of example, and you can try to create more value with cash on the balance sheet as well as lending products, there are revenue synergies. So when you look at the opportunity for consolidation, there is very little doubt that it creates significant shareholder wealth. I suspect it will happen. When it will happen exactly is unclear. I think certainly we recognize the value of consolidation and would welcome the opportunity to participate. And as we look forward, one of the things that I think may be helpful is if you are in a little bit more difficult macroeconomic environment and particularly it is creating or wreaking a bit of havoc on the equity markets and it puts some pressure on people's numbers, then there may be increased opportunity for consolidation hopefully in the mid-term.

<Q – Scott Patrick>: Okay. Great. I think Jarrett in his comments had mentioned about 3.5 billion available for sweep. I mean, is that something you can do fairly quickly or should we expect that to happen over time.

<A – Mitchell Caplan>: A good way to think about this is that what we were really trying to bridge to is cash that is on the balance sheet related to trading and investing accounts. And so to be clear, if you look at that number, it is about $5.5 billion. There is in the neighborhood about $2 billion that is currently not sweepable in our minds and the reason that's the case is it really applies directly to tax-exempt products where our customers – in shutting down our money market business, we moved over the tax-exempt products to Vanguard. And so as a result of that, if you look at the cash on our balance sheet you see the segregated cash going up dramatically. That's a big part of that number. We backed that out of that equation and we look at it and say there is somewhere in the neighborhood of about $3.5 billion that's available for sweep. We do believe there is an opportunity to attack a large part of that throughout this year. Again, I think what Jarrett said in his comments and in his notes was that we presume most of those things can be attacked in the latter half of the year, meaning the last two quarters. But again, we would expect to continue to make progress in Q2 with increased progress against that in Q3 and Q4. At the same time, the same issue is associated with moving clearing under the bank. There is a significant pickup there. Again I think we guided to the latter half of the year for that. And with respect to the balance sheet management, you will continue to see us do that in Q2, Q3 and Q4.

<Q – Scott Patrick>: Okay. Just one other question. In March it looks like you lost some brokerage accounts while at the same time you had some pretty strong growth on the bank side in terms of accounts. Can you put a little color around that?

<A – Mitchell Caplan>: Sure. One of the things that's happening obviously is we launched Complete and we have begun to spend more of our marketing dollars outside of what you would view as the traditional trading environment and you are beginning to make customers both internally and externally more aware of the products that we offer around lending and/or cash management. You are going to see continued improvement in those numbers. So that's, in my mind, an early indication of the measurement of our opportunity to try to grow top line accounts and deepen the penetration with our existing customers through these other products in both banking and lending.

<Q – Scott Patrick>: Okay. I guess any particular color you can give kind of on what type of accounts you were losing though on the brokerage side?

<A – Mitchell Caplan>: Yeah, by and large, if you look at it, it is predominantly mainstream customers. In March I think as you are aware, it was the first time we were beginning to make our customers aware of the increased AMF fee from $25 to $40. At the end of the day, if we are losing customers or accounts whether it is through attrition or through inactivity, a lot of that will be driven been by increased AMF fee, and we recognize that all of that is due to the fees, and frankly we are comfortable with that because you can well imagine that the customer that you are losing who either has less than $10,000 or doesn't trade once in a quarter is not creating the kind of value of the customers who are bringing in $2 billion net in new assets in the quarter.

<A – Jarrett Lilien>: And basically we are seeing consistent with what we've told people we expect, which is we got some group of mainstream accounts that are just not opportunities for us and those are generally – they continue to be the types of accounts that we lose and what we have seen that's encouraging, it's very early days, the new pricing was right in the middle of the quarter, the new marketing was basically a week left in the quarter. And we have already though begun to see a nice shift in the types of new accounts that are coming in, more towards serious investor and continued active trader.

<Q – Scott Patrick>: All right. Great. Thank you.

<A – Mitchell Caplan>: Absolutely.

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

<Q – Richard Repetto>: Yeah, hi guys.

<A – Mitchell Caplan>: Hi Rich.

<Q – Richard Repetto>: First question on the balance sheet, can you give us a feel for how much you could grow the balance sheet? I see – I can see the rotation that Jarrett is talking about. The MBS coming down and sort of the mortgage and HELOCs going up.

<A – Mitchell Caplan>: Yeah. Let me say a couple things. One is we strategically slowed growth of the balance sheet this quarter. The reason we did that is because conceptually what we are trying to do over time, and we talked a little bit of this at analyst day, I think our review of the management team you want your balance sheet in the bank behind door number one to grow as a result of strengthening your relationship with the retail customer. You continue to grow the liability side of your balance sheet by selling deposit and cash products to your customer, and you grow the asset side of your balance sheet as a result of selling credit or borrowing or lending products to your retail customers. We are beginning to see that happen, so one of the things you can look at is you are in a place where we are now originating mortgages and HELOCs that we traditionally would have sold but now we are putting on balance sheet because they have the characteristics that are more appealing to us and that's a part of what you see as we are switching out of mortgage-backed securities as you just noted and into the whole loan type product. We see that as a continued opportunity. Given that and given what I am seeing now on the incremental return associated with that, we are way past the return hurdles that Rob has set for each of the businesses in order to give them capital. We are in a place where certainly I am extremely comfortable with the guidance that we gave at the beginning of the year about balance sheet size, and to your question, to the extent that we see greater opportunity because there is enhanced growth around cash by selling to our retail customers as well as enhanced growth around lending products on the asset side, then we will evaluate as appropriate in each quarter and adjust the balance sheet assuming that it continues to surpass the target hurdle for a risk adjusted return that Rob set.

<A – Jarrett Lilien>: And Rob I guess – or, Rich, sorry, in our guidance, we originally saw in our future a balance sheet, an average size of 27 to 28 billion and we are still comfortable with that.

<Q – Richard Repetto>: Okay, okay, and then. Well, I guess you know when we look at the yield and how you have already started repricing for E*TRADE Complete, I guess the appropriate question is the status on how we are doing with this pretty key product, I guess.

<A – Mitchell Caplan>: Again, one of the things you are seeing, and we talked about it, was growth in the deposit accounts, growth in deposit balances. It is early indications and it really is too early. If you think about it, we began to reprice some of the liabilities earlier in the quarter in contemplation of launching Complete. But when you start looking at the significant marketing dollars, they were spent later in the quarter. So under any circumstances, I feel like the early indications are we have been successful at trying to grow those balances and also to try to increase the penetration of products per customer. So going forward, I feel good about the opportunity to be able to grow cash and lending products through the Complete offering, certainly given the marketing dollars that we are putting behind it.

<A – Jarrett Lilien>: And Rich, a couple other facts for you. We converted 53,000 accounts on March 25th. And that was really our roll out. So it was very small. We got it started. We got a million accounts that we are converting over next week and then another few hundred thousand next month. So it is early days. To be fair, the results so far are pretty much anecdotal but very positive. But the real impact is going to take a little bit of time. And again just 53,000 accounts so far. The real information we are going to start to see is later in this present quarter as we will have some real scale converted over and using the product.

<A – Mitchell Caplan>: I think, also, Rich, to your point, I didn't make this point earlier. When you look at the opportunity in front of us, one of the things that we had to do – I know we've talked about this at analyst day, was we had to step back and look across all of our products. Jarrett talked a little bit about this in the comments earlier. We had to look at everything. So it wasn't only our trading solutions and how we were pricing them but it was also our margin as a product and what we were charging our customers. We had to look at cash and what we were paying on that across the board. We had to look at the other lending products, whether they were mortgages or HELOCs, and you know as well as anybody that we have already begun the process of bundle pricing independent of Complete and we are furthering that with Complete. But one of the things that we felt was crucial to us was to be accurate in assessing how we stood against the competition in all of these products and make sure that we felt we were in a competitive range. Again, we do not feel the need to be the lowest price or the highest yield on any of these products. But we believe we need to be in a value-based range or a competitive range. And in looking at that, we took a one-time adjustment on our pricing around cash with our CDs, our money market, our sweep product, all of them. That's what you are seeing here. Going forward, we now feel we are in a competitive range so what will happen is as the Fed tightens and interest rates rise, you will be in a place where clearly we will increase what we are charging to our customers and we believe that what we are paying will lag because that's typically what happens in the industry and we believe that we will get to participate in that. So a big part of the 14 basis points that we saw in this quarter was really a one-time adjustment to move us in the range of being competitive versus all the other cash solution providers in the marketplace.

<Q – Richard Repetto>: Gotcha, gotcha. This will be my last question. Not to hog all the questions. It looks like investors right now are concerned, it is pretty well acknowledged that trading environment is softening. I am not going to ask you what your DARTs are this month. But I think what everybody is concerned about is how you can offset – we know commissions are down at 20%. But where most other guys have, they can, they get the levers of marketing, it appears like you have other levers. I guess the question is, if trading slows and if it goes beyond April through whatever month it goes to, do you operate differently or are all these other levers like the sweep, like the balance sheet growth, et cetera, are they just automatically already programmed to kick in? Or are there other things that if you see a slowing trading environment that you can pick up the slack, frankly, that your competitors can't do that?

<A – Mitchell Caplan>: I would agree. And so it is why we were comfortable obviously, as you see both in our press release and on the call, in affirming the guidance that we gave last December for this year. So to answer your question, you know, we guided outside of trading. We guided to margin ranges and we are now still outside the high end of our range around margin. And by and large I think everybody in the industry, but particularly us, we have experienced a lot more stability in those margin balances. What we are now beginning to see also is some spread widening there. Again, not any different from the cash products, we stepped back and said we believe we needed to become more competitive in what we were charging our customers around margin. We actually adjusted for that so when there were a series of rate rises, we did not take advantage of that.

Going forward, we now believe that we are competitive and we will react in response to what's happening in the marketplace at large. So I think there is some opportunity there. When you look at the balance sheet side, clearly as Jarrett said, he gave you the ranges. We remain comfortable with that. To the extent that we are generating a risk adjusted return that meets Rob's hurdle rate, we do have the opportunity to grow the balance sheet larger if it makes sense on an economic return basis, we do have the capital available to deploy and grow. And we've certainly outlined for you how we look at the opportunity to get from the 220 to an average of, that is the low, to 233 in spread for this year. Again we stated we feel comfortable with that range. So we have all of that. When you look at marketing, I do believe that we will continue to remain committed to the strategic marketing around assets and asset gathering around Complete, around our cash products. That said, a portion of our marketing budget is directly attributable to trading. If trading volumes are lower, we will drop our spend. We are going to be prudent in expense so we are going to be committed but we have got to be flexible as we look at the environment in the market. And lastly, as you saw, one of the things that we talked about specifically was sort of in Josh's world around operations, service technology, we signed up for $60 million in saves. You saw in the neighborhood of 4 million. If you annualize that, it would be 16. We still remain comfortable with getting to 60 million. And so I think you would expect to see us be very prudent around expenses throughout the rest of this year.

<A – Jarrett Lilien>: Just reiterating something else that was out of the script, if we really have just an awful summer and people liquidate some of their share holdings and go to the sidelines and are inactive, again, one of the great unique parts of the model, $15,000 of cash is as good as an active trader. People go to the sidelines, that's fine with us, too. And all we want them to do is keep that business with us.

<Q – Richard Repetto>: Gotcha. Thanks, guys. We will be talking.

<A – Mitchell Caplan>: Absolutely.

Operator: Your next question comes from Matt Snowling with Friedman, Billings, Ramsey.

<Q – Matthew Snowling>: Hi guys.

<A – Mitchell Caplan>: Hey, Matt.

<Q – Matthew Snowling>: One more question on your balance sheet. I was wondering, does your margin assumptions, is that based on a certain yield curve environment? Does that change if we somehow get into a flatter…

<A – Mitchell Caplan>: It is based on an assumption that we have both a rising interest rate and a flattening yield curve, right? And so right now if you look at – and I took you through this last quarter, but if you looked at our position in terms of interest rate risk and mismatch, we are sort of neutral. So we are at a place where we are fine, and I think one of the things that I do pretty consistently is I try to step back and look at some context of what's happening. So here we are through the first quarter of 2005. What I can tell you is last year, 2004, was no walk in the park. So from 2004 exiting 2003 till the end of 2004, you saw a widening of spread of about 50 basis points. We did that widening during a period of time while Fed funds increased from 100 basis points to 225 basis points or basically you saw in the neighborhood of 125 basis points of increase in Fed funds and the yield curve flattened so that the spread you were picking up between the 2's and the 10's went from 226 basis points down to 115 basis points. If you even flash forward through Q1 we have been able to widen our – literally from 185 to 220 basis points during that period with 175 basis point increase in Fed funds and 156 basis point in flattening. So there is very little doubt in my mind that we have been able to continue to meaningfully widen out our spread internally while doing it in both a rising and flattening yield curve over these last five quarters.

<Q – Matthew Snowling>: Where did you exit the quarter in terms of the spread?

<A – Mitchell Caplan>: We actually specifically didn't address it. You can assume it was slightly north of where we ran. So there was improvement.

<Q – Matthew Snowling>: One follow-up question here. On Reg NMS, wondering if you can give us your thoughts on how that affects the business.

<A – Mitchell Caplan>: Let me take a quick shot at it and then, Jarrett, if you want to add anything. We have done that. The very first thing we did post-NMS, is obviously we've followed it throughout. Immediately after NMS was implemented we went back and we looked at our market making business and tried to understand what we perceived as both the upside, downside. So given everything that we're seeing, we would expect revenue to be impacted somewhere in the neighborhood of $2 to $5 million annually. So it is relatively de minimus when you look at the revenue impact. We have told you historically and now we are running about a 30% up margin in that business, sort of in that range. It would give you some indication of the de minimus impact it would have on our earnings for the year. We have presumed in that that there is no offset. However, Jarrett's view is that to the extent that you start seeing more people trading through the New York Stock Exchange and you look at more of our retail customers doing that, there could be an offset to some of that in the volume that would move through our E*TRADE capital markets market making division.

<A – Jarrett Lilien>: Yeah. I don't know if I would add much. Though, I actually think Mitch laid out sort of a risk level. I think that's sort of your worst case, everything goes wrong and there is no pick up. That's about as much risk as we can try to find in it. I really think it is pretty much a non-event for us and we were agnostic towards this event both from a P&L perspective but also pretty much from a customer perspective. We want what's best for the customer. Ultimately if it's good for the customer, that will drive more activity. I wasn't sure really if it was a positive for the customer or not.

I think with the news this afternoon with the Exchange and Archipelago and maybe that moves them more towards an electronic fast market, that maybe overall this is a positive for the customer. Could lead to increased activity in the New York Stock Exchange. And while there is risk if everything goes wrong, I think there is about equal amount of opportunity if a couple things go right.

<Q – Matthew Snowling>: Fair enough. Great quarter guys.

<A – Mitchell Caplan>: Thanks a lot.

Operator: Your next question comes from Richard Herr with KBW.

<Q – Richard Herr>: Hi. Good afternoon guys. How are you?

<A – Mitchell Caplan>: Hey Rich.

<Q – Richard Herr>: Just a couple of quick questions. Starting with the loan repricing, how many more schedules do you think we may need to see before you guys may have to address – I'm sorry your deposit repricing again?

<A – Mitchell Caplan>: I don't think we have to – I think we will only address deposit repricing going forward in connection with interest rate moves. We are now incredibly comfortable by and large with what we are paying for our deposits across the board. Will we or could we going forward look at particular customer segments and offer a different rate based on a bundled offering where the value is inherently delivered to us? Sure. But in terms of general repricing of our liabilities for our retail customers, we feel like we have taken that action, we took it in Q1. We knew we were going to do it as we planned strategically for this year. And what you will see by way of example is now as interest rates rise, we will reprice but we will price in order to remain competitive. And as you know the industry typically lags on that repricing versus the yield on your corresponding asset.

<A – Jarrett Lilien>: A little extra on that, too. Everybody focused on what we did with commissions. Really on commissions, the area where we really changed was Main Street where, that was an area where we have been seeing a lot of attrition. Some of it attrition we didn't want to lose but an area where we were really uncompetitive so we got competitive. Margin pricing, we don't talk about it much but we have been pretty uncompetitive with margin pricing and as rates have been rising, we had not been increasing our margin rates. We are now in line and have – did raise some of our margin rates with the last Fed hike and the same goes now with cash. We had some rates we were offering which were just not competitive. What we have done in the last quarter is we have gotten our whole pricing competitive, whether that's commission, margin rates, or cash. Now we are able to go with the market and then as Mitch said, look for those special things that we can do around bundling around E*TRADE Complete where we can hope to bring in even more assets.

<Q – Richard Herr>: Okay. Just maybe focusing a little bit on the different liabilities on your balance sheet, it looks like the retail deposits only increased about a basis point in terms of the cost to you. It looks like the bigger increases were the brokerage CDs and the FHLB advances?

<A – Mitchell Caplan>: You can't do that because it was all a function of where we attach the hedges. We are happy to walk you through that, pre-hedged and post-hedged.

<Q – Richard Herr>: Okay.

<A – Mitchell Caplan>: But I can assure you at a top level that it is all in the retail deposits.

<Q – Richard Herr>: Okay. Mitch, I love to ask you this question every quarter on the provision expense, you are provisioning pretty conservatively. Any new we need to hear about, anything you expect coming down the pipe with balance sheet growth. Anything like that?

<A – Mitchell Caplan>: Nope. If you look at the provision, I think what you see is it looks very much like last quarter. We provisioned about 12 million. If you look at the value of charge offs it was below that. And number one, number two when you look at sort of how we – it broke down, it broke down exactly as we expected in terms of both charge-offs and reserves between the mortgage product and then between the non-mortgage or consumer financed product. There is nothing we're seeing at all in terms of a trend a line out of what we have modeled or what we had traditionally seen.

<Q – Richard Herr>: That's helpful. And lastly maybe two quick things. Just the product per customer and what are those products that they are using and also what kind of progress do you have on the options roll out?

<A – Mitchell Caplan>: Okay. Happy to do it. So the products per customer if you see we have gone from 1.7 to over 1.9 year-over-year. It is almost at 2. It almost rounds to 2. Obviously we are trying to expect to try to continue to do that. By and large the way you should think about products is anything that generates revenue and profit. So rather than thinking about it more aggressively in the marketplace or in functionality – we can do this off line and go product by product if you would like, but my view when we sat down, Jarrett, Rob and I went through it, if a product generates revenue for us then that's how we should think about it. It is not only customer engagement. It has got to be customer engagement driving revenue with the opportunity to control expenses and be more profitable, okay? Last on options. Want to do it? Where are we in terms – we talked about really focusing on options. We have done a lot in terms of our functionality.

<A – Jarrett Lilien>: Getting confused on so many options out there. We talked about expensing them. Okay, on options…

<A – Mitchell Caplan>: Is that what you meant, Rich? Did you mean the options product?

<Q – Richard Herr>: Absolutely, the options product. Yeah.

<A – Jarrett Lilien>: The options product, I mean we've got a pretty full pipeline of just consistent weekly rolls that are coming out with new things and basically what we want to do there is just be top of the market and own the space. Maybe Josh can probably help and give me some specifics maybe but we're coming out aggressively as we've said to own that space and that's going to be in terms of where we are. Right now we think we are with price, with relationship managers who our options experts and then with these weekly rolls of better functionality to attract a true options professional.

<Q – Richard Herr>: Are you seeing an increase in options trading? I know the CBOE just the other day had a record day.

<A – Mitchell Caplan>: One of the things, I just looked at our numbers and options as a percent of total trades is up quarter over quarter and also in terms of revenues. So it is not only just that you had declining trades and so options became a bigger percentage. It also in terms of actual dollars generated for us as well. The answer is we are definitively moving market share in the options; we said we wanted to. We feel comfortable with the pricing and where we price; we know there is a lot of marketplace going on all around us with competitors. When we look at current pricing we look at the functionality and we look at the service as Jarrett talked about with these relationship managers who we hired who are actually options experts, we feel like our offering is compelling and we would expect to continue to see growth in it.

<A – Jarrett Lilien>: One of the reasons, it's just such an attractive area right now. 10% of DARTs and that number has been increasing, but it represents about 20% of commission. It is an area we want to do more in and we're going to go on the offense. It is also an area where we are not going to allow anybody else to come in and take from us because it is pretty valuable.

<Q – Richard Herr>: All right thank you very much.

<A – Mitchell Caplan>: Absolutely.

Operator: Your next question comes from Adam Starr with CRM.

<Q – Adam Starr>: Just a couple questions on the balance sheet. I think you may have answered this. The average consumer deposit balances were down year-over-year. Does that – can you net hedges against the balance?

<A – Mitchell Caplan>: The average consumer are down just because they are flowing out. So, for example, as you may or not remember we had auto on the bank's balance sheet a year ago. When we looked at the economic returns associated with trying to originate that business in-house, we just decided it just wasn't going to generate a return that was satisfactory to Rob. We stopped it and we have allowed that to bleed off. That's what you are seeing in terms of the decline. In time, you will see it grow and it will be entirely comprised of products that are more related to E*TRADE Complete.

<Q – Adam Starr>: Okay, but the retail deposits also showed a decline. Did you run off some high-cost CDs? When I look at the average balance of the quarter, you were at 11,865 versus a little over 12 a year ago but doing a much, much better price.

<A – Mitchell Caplan>: Yes is the answer. It is up quarter over quarter, down year over year, and the reason that's the case is, we go to a place where we were taking not only the CDs but everything, money market, everything we viewed as a high cost deposit and more importantly, I think you know, Adam, where we didn't believe there was an engagement with the customer. That customer bought that as a single product. They didn't log on. They didn't feel engaged with us. So we just said we are going to allow ourselves to bleed it off because it is a high cost and it's not the right way to build a retail franchise. Going forward you will see us continue to grow those and if you see growth in any product, whether it is money market, sweep or CDs, it is really going to be because that customer is more linked in in a bundled way and has other products with us.

<Q – Adam Star>: Great. On the asset side, where do the margin loans show up? Are they listed with the 4.2 billion in consumer loans?

<A – Mitchell Caplan>: They don't. They do not, yet. So for purposes of presenting retail and institutional, they show up as an asset and they show up in the net interest income number so you see them on a consolidated basis as part of interest income and interest expense. At the point at which we put clearing under the bank and we solve for that, you will then see it on bank's balance sheet.

<Q – Adam Starr>: They just show up on a receivable on the balance sheet, as a brokerage receivable.

<A – Mitchell Caplan>: Exactly.

<Q – Adam Starr>: Okay. Very impressive numbers. It would seem that the bank is really becoming the driving force in this environment.

<A – Mitchell Caplan>: You know, I'm not even sure I'd call it the bank, I think I'd call it the balance sheet.

<Q – Adam Starr>: Okay. The non transaction side.

<A – Mitchell Caplan>: Yeah. I think what we are finally beginning to crack here is we are at a place where, as you know, trading volumes are 20% of revenue. We are starting to really take a retail customer which happens to be predominantly a quote unquote brokerage retail customer and maximize as much value as we can out of that customer because they are bringing over more cash and they are bringing over more credit in the form of margin and other products and we have a unique model in the sense that as you know we can put it on balance sheet and create more value for both the customers and the shareholders.

<Q – Adam Starr>: Does this mean that you have to adjust your targeting and your marketing and find more customers who are driven by the balance side of the business?

<A – Mitchell Caplan>: Absolutely. And I think you are seeing it and will absolutely continue to see it. So some of the first marketing that came out by Nick tended to be more trading centric because it was marketing under the umbrella of challenge the ordinary, be extraordinary. But it was around the trading solutions with some of the new price points and some of the new functionality. We are now starting to run spots for Complete. We are running other spots that are more asset focused, whether it is cash or other forms of assets and the same will be true on the lending business. Yes, we are transforming the brand and we are also spending more aggressively in products outside of what has been the traditional trading solutions.

<Q – Adam Star>: Okay. Thanks a lot. And good work.

<A – Mitchell Caplan>: Absolutely. Thanks a lot.

Operator: Your final question comes from Campbell Chaney with Sanders Morris Harris.

<Q – Campbell Chaney>: Good afternoon, guys.

<A>: Hey, Campbell.

<Q – Campbell Chaney>: I have a question on your buy back. I think Rob said that there's 200 million and that you find the attractiveness of the buy back. My question has to do with, is there enough cash outside of the so-called bank that you could fund the $200 million buy backs so not to use your capital outside of the bank so you can still grow the balance sheet as you desire?

<A – Robert Simmons>: Campbell, let me take that. First of all, when we came out with guidance, we had forecasted that we would be doing a certain level of repurchases throughout the year. We are obviously – the beauty of the share repurchase program is that you do have the ability to be opportunistic a little bit in it. So we are taking a look at the capital that we have allocated against that given the current environment that we're in.

<Q – Campbell Chaney>: Okay. But that's kind of outside the bank, I would say.

<A – Robert Simmons>: The cash used for share repurchase purposes is at the holding company level.

<Q – Campbell Chaney>: Correct, right. Okay, so that's been funded. Any thoughts about increasing that buy back now that stock is here under 11? It seems like it would be accretive to your EPS level.

<A – Mitchell Caplan>: I agree. One of the things that we have done traditionally – Rob is smiling – is that obviously it is a board-approved policy. We talked about how much we bought back in this quarter. We talked as you just mentioned as to what's left in the buy back. I would suspect at the point at which we use that, we talked about using it over the course of the rest of the year, if we are more aggressive in our buy back between now and the end of the year and we need to go back to the board, it is simply a function of making the presentation about the risk adjusted return on that capital for the buy back versus anything else. And so far our board has been very supportive in looking at any alternative that we want to consider that generates a return in excess of a hurdle rate.

<A – Jarrett Lilien>: That's right. The good news is we have got lots of competing projects that are looking for capital. Lots of nice opportunities to invest that. And we look at where we feel the most attractive opportunity is. And that has historically included share repurchases and will likely continue to do that.

<Q – Campbell Chaney>: One just fine one, kind of, off topic. On your corporate services your employee stock option, you mention that had in your analyst day. Is that something you are starting to track and you're starting to pursue to keep those customers and their funds at E*TRADE?

<A – Mitchell Caplan>: Absolutely. Let Jarrett nail it...

<A – Jarrett Lilien>: We have and we are and we already started doing things. And E*TRADE Complete actually fills the bill here in a big way. What we found late last year, if we sort of put a little speed bump in places, people exercised options, sold, had cash and then thought what to do about it. What we wanted to do is have them keep that money with us and we started offering them some better rates while they kept the cash with us and we found that the retention rates on that cash was very big. So now we are coming back with, again, our whole sort of trilogy there of better price, better functionality, better service. And we are finding that we are keeping more of those assets. It's a very unique thing about our business model and one of the big focuses in terms of initiatives for us for this year and beyond. We could go almost as far as not acquire any other customers except convert more of these customers and retain more of their cash and we'd have great growth on that alone. So you are right, this is a big positive for us and we are starting to get results now.

<Q – Campbell Chaney>: In your guidance for the year, how much are you putting into this business, if any? If it really gets traction, is it going to be all upside?

<A – Mitchell Caplan>: It is not a business where you have to invest a lot more money in. What we have to do because, as you remember, we are getting corporate customers with our stock plan administration services. That actually is not going to require us a lot of investment from here to help continue to grow that. The real trick of what we have got to do is get the employees of those corporate customers to, when they exercise and sell and have a bunch of cash, to keep that cash with us and either invest through us, trade through us, do their banking through us or borrow through us with mortgages or home equities or what have you. And that's where we are focusing. And I think a lot of that investment we have already made, again, with the pricing changes we've made with E*TRADE Complete, the product and functionality and so on and so forth. A lot of that investment is already in our numbers.

<Q – Campbell Chaney>: I was thinking more just from the standpoint, not investing, if you start getting traction in this business.

<A – Mitchell Caplan>: You are right. If you look at the guidance we gave around assets, around trading, around cash and around lending, we assume the behavior characteristics of those customers was no different than the traditional behavior customers of retail at large and that it bore the same percentage that it has traditionally borne. To your point that we continue to make traction in it, then that's a good thing because it's a customer who clearly, when you look at the revenue being generated, has a higher relative return for us.

<Q – Campbell Chaney>: Fair enough. Thanks. Good quarter.

<A – Mitchell Caplan>: Thanks a lot.

Operator: You have no further questions at this time.

<A – Mitchell Caplan>: Great. Thanks very much everybody for joining us. We will speak to you next quarter.

Operator: That concludes today's E*TRADE's Q1 earnings call. You may now disconnect.