
MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the E*TRADE Financial Third Quarter 2010 Earnings Conference Call. At this time, all participants have been placed in a listen-only mode. Following the formal remarks, we will open the call for Q&A. [Operator Instructions]

Thank you. It is now my pleasure to turn the floor over to Susan Hickey from E*TRADE Financial. Please go ahead.

Susan Hickey, Media Relations

Thank you. Good afternoon, and thank you for joining us for E*TRADE Financial's Third Quarter 2010 conference call. Joining me today are Steven Freiberg, E*TRADE's Chief Executive Officer; Bruce Nolop, our Chief Financial Officer; and other members of E*TRADE's management team.

Before turning the call over to Steve, I'd like to remind everyone that during this conference call, the company will be sharing with you certain projections or other forward-looking statements regarding future events or its future performance. E*TRADE Financial cautions you that certain factors, including risks and uncertainties referred to in the 10-Ks, 10-Qs and other documents E*TRADE files with the Securities and Exchange Commission, could cause the company's actual results to differ materially from those indicated by its projections or forward-looking statements. This call will present information as of October 20, 2010. Please note that E*TRADE Financial disclaims any duty to update any forward-looking statements made in the presentation.

During this call, E*TRADE Financial may also discuss some non-GAAP financial measures in talking about its performance. These measures will be reconciled to GAAP either during the course of this call or in the company's press release, which can be found on its website at investor.etrade.com.

This call is being recorded. A replay of this call will be available via phone, webcast and podcast beginning this evening at approximately 7 PM. This call is being webcast live at investor.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

And with that, I will now turn the call over to Steve Freiberg.

Steven J. Freiberg, Chief Executive Officer

Thank you, everyone, for joining us today. To begin this afternoon's call, I will cover highlights from the third quarter and then Bruce will take you through the results. From there I'll share some thought on the opportunities we see for the business, after which we will be happy to take your questions.

The third quarter was an important one for E*TRADE as we delivered our second consecutive quarterly profit. We reported pre-tax income of 36 million and achieved positive net income for the quarter, despite an unusually high reported tax rate. Strength in a number of areas supported our performance in a quarter that was notable for the industry-wide decline in trading activity and a challenging interest rate environment. We were pleased with the growth in net new assets and average margin receivables and with the quality of new accounts in the brokerage business. Improvement in loan performance trends drove the 8th consecutive quarterly decline in our loan-loss provision. Effective balance sheet strategies resulted in solid net interest income, and we benefited from opportunistic gains in our securities portfolio.

Our results demonstrated progress in positioning the company for sustainable profitability and growth as we continued to execute on a number of key objectives. Our provision for loan-losses has been below charge-offs for five consecutive quarters. We have generated organic bank regulatory capital each quarter this year, and we have delivered our second consecutive profitable quarter.

During the quarter, we executed on a number of initiatives to expand our offering to both active traders and long-term investors. In June, we released application programming interface, or API, allowing third-party vendors and independent software developers to interface seamlessly with our investing platform. In September, we introduced new research and trade-idea generation tools, including market commentary from Dreyfus and Buzz & Banter from Minyanville, a leading business and finance site.

Also in September, we launched a new cross-media ad campaign, including TV spots that are running during highly rated fall sporting events and prime time programming. The campaign with a new tagline, Investing Unleashed, includes several new E*TRADE Baby spots as well as product ads that speak directly to self-directed investors who are ready to take control of their finances. It is a high-impact campaign that moves the brand forward and positions us well for the fourth quarter, as well as 2011.

In addition, our ongoing investment in the overall customer experience, including a growing relationship management team and simplified pricing continues to pay off. This supported a sequential improvement in our annualized brokerage account attrition rate from 13% to 10%, our lowest attrition rate in more than six years and a level we will strive to sustain over the long run.

We also received industry recognition for our Corporate Services organization from Group 5, the leader in equity compensation research, which named us number one in overall satisfaction and loyalty for Stock Plan Administration in its 10th Annual Benchmarking survey. Our Corporate Services group, which provides stock plan administrative tools and services, continues to gain traction and now counts 20% of the S&P 500 as clients. This continues to be an attractive opportunity for us, both as a standalone business and as a meaningful source of new retail brokerage accounts.

With that, I will turn the call over to Bruce to take you through our results for the quarter.

Bruce P. Nolop, Chief Financial Officer and Executive Vice President

Thank you, Steve. While we were affected by the decline in overall trading, we were pleased with our results, which were supported by strength in our brokerage business, continued positive trends in our loan portfolio, and solid net interest income.

We reported net income of 8 million or \$0.03 per share during the third quarter, which compares with net income of 35 million or \$0.12 per share in the prior quarter and a net loss of 855 million or \$6.74 per share in the third quarter of 2009. Our third quarter 2009 results included a non-cash charge on debt exchange of 773 million or \$6.09 per share. When excluding the impact of the debt exchange, we had a net loss of 82 million or \$0.65 per share in the third quarter of 2009.

We reported pre-tax income of 36 million for the quarter, but as Steve noted, we had an unusually high reported tax rate this quarter. So let me explain. Although our actual tax rate continues to be approximately 38%, our reported tax rate is much higher, because certain of our expenses are not deductible for tax purposes. For example and most importantly, about one third of our interest expense on the springing lien notes is not deductible for tax purposes.

Therefore, while our reported pre-tax income is 36 million, our income subject to taxation is higher, resulting this quarter in a much higher reported tax rate of 76%. This is due not only to the higher amount of taxable income, but also to the fact that our reported pre-tax income for the year is relatively close to breakeven. The additional pre-tax income from the springing lien is about 35 million per year, and the annual tax on that income is about 10 million. Therefore, this issue will be mitigated if our reported pre-tax income grows in the future.

We produced 489 million of net revenue during the quarter, a decline of 45 million from the prior quarter and down 86 million or 15% from the same quarter a year ago. The decline in revenue was driven almost entirely by the decrease in trading activity, as was experienced across the industry.

We were pleased to maintain a relatively consistent level of interest income of 299 million. The 3 million decline from the prior quarter reflected a 1.3 billion decrease in average interest earning assets to 39.7 billion, which was largely offset by a 6 basis point expansion in net interest spread to 2.95%. This reflects our strategy of maintaining a relatively consistent net interest spread despite an environment of declining interest rates.

Commissions, fees and service charges, principal transactions and other revenue in the third quarter were 151 million. This was down 23%, compared with the prior quarter, and was impacted by the decline in DARTs and a very slight decline in average commission per trade from \$11.05 to \$11.03.

Our revenue this quarter also included 40 million of net gains on loans and securities, including a net impairment of 7 million as we managed our investment portfolios to limit our risk and we realized gains due to favorable market opportunities. This compares with 37 million of net gains in the second quarter and 23 million in the third quarter of 2009.

Our total operating expense for the third quarter declined 3% or 9 million from the prior quarter to 267 million, which represented a 12% decline from the third quarter of 2009. This included lower compensation and clearing expense, as well as a 6 million credit against professional service fees as part of a legal settlement.

Let's turn now to metrics. As noted, we experienced a slowdown in trading activity over the summer, certainly in comparison to record highs in recent years. DARTs for the third quarter were 127,000, down 26% from the prior quarter, and down 30% compared with the third quarter of 2009.

Nevertheless, we saw strength in a number of areas. Net new asset flows into our brokerage business were a positive 1.4 billion during the quarter and totaled 5.7 billion year-to-date. Net new brokerage accounts were 7,000, bringing account growth for the year to 27,000, and we ended the quarter with a record 2.7 million brokerage accounts. Brokerage customer cash increased by 1.9 billion to 22.6 billion, while customers were net sellers of 1.3 billion in securities. Bank customer cash declined by 600 million. In total, we experienced a net increase of 1.3 billion of customer cash deposits, which was a positive contributor to our net interest income.

Another positive contributor was increased margin loans to customers. Average margin receivables grew by 4% during the quarter from 4.5 billion to 4.7 billion. This represented a 52% increase from a year ago.

We were pleased with the performance of our loan portfolio. The portfolio contracted by \$1 billion during the quarter, and our loan loss provision declined from 166 million in the second quarter to 152 million in the third quarter. This is the eighth consecutive quarterly decline in the provision, which is now 71% below its peak in the third quarter of 2008.

Loan charge-offs declined slightly from 225 million in the second quarter to 222 million in the third quarter. This is the fifth consecutive quarterly decline, and charge-offs are now 43% below their

peak of 386 million in the second quarter of 2009. The allowance for loan losses ended the quarter at 1 billion, down 70 million from the prior quarter, and remains at 6% of gross loans receivable. We expect that credit costs will continue to decline, however, because the timing and magnitude of the improvement is affected by many factors, we anticipate variability in any one quarter, while continuing to see a downward trend over the long-term.

Related to the recent decisions by a number of banks to suspend or review their foreclosure programs, we do not expect any material direct impact, although we may be indirectly affected as any delays work their way through the system. As a reminder, E*TRADE does not service any of its loan portfolio, and we rely exclusively on third-party servicers.

We are pleased that the Bank generated capital again this quarter. The Bank generated 81 million in regulatory risk-based capital, bringing the year-to-date total to 191 million. As of September 30, the Tier 1 capital ratio was 7.41% to total adjusted assets and 13.75% to risk-weighted assets. We ended the quarter with 1.1 billion of risk-based total capital in excess of the level that our regulators define as well capitalized.

On a consolidated basis, we ended the quarter with 1.5 billion in Tier 1 capital and our tangible common equity was 2.1 billion, both slightly higher than second quarter levels. We ended the quarter with 490 million in corporate cash. This is an increase of approximately 9 million from the prior quarter and included a \$34 million dividend from the Bank.

Finally, I want to note that our corporate interest income this quarter benefited by 6 million from a legal settlement. In all, we were very pleased with our performance in the quarter, and look forward to building on our momentum.

And with that, I will turn the call back to Steve for additional remarks.

Steven J. Freiberg, Chief Executive Officer

Thank you, Bruce. Before opening the call for questions, I would like to share a few comments related to future plans and initiatives.

When we spoke last quarter, I had been on board approximately 100 days, and we had just reported our first quarter of profitability in three years. The company has achieved a number of important milestones, allowing us to shift gears from defense to offense and providing the flexibility to review opportunities for future growth. We since have focused on areas where we see potential for driving enhanced growth and profitability. I will highlight four categories:

First, we have a solid retail brokerage franchise that has performed extremely well throughout its history, most recently contributing great results that were often overshadowed by challenges in the loan portfolio. With a base of all-time high 2.7 million brokerage accounts, complemented by enhanced marketing spend, we believe there are continued opportunities to expand our relationship sales, product and service initiatives to grow our active trader and long-term investor, customer bases.

Our growing sales force will emphasize long-term investor retirement solutions, including the advisor-based management investment portfolios, as well as a full suite of fund and fixed income brokerage product offerings. We will also continue to expand our offering for active traders and are in the early launch phase of portfolio margining, three- and four-legged option spreads, E*TRADE communities and additions to our mobile trading applications, specifically E*TRADE Mobile Pro for Android.

On the marketing side, as I mentioned earlier, we have been involved – we have been evolving our advertising to include product- and service-focused messaging in addition to iconic E*TRADE Baby. And we believe we have a terrific opportunity to better engage with the 15 million prospects that visit our website each year.

Second, we have significant institutional brokerage opportunities, notably our Corporate Services and Capital Markets groups. Both of these businesses have scale and are market leaders. Our Corporate Services group continues to make progress with new and expanded businesses in both software and services, and is an important source of new retail brokerage accounts. Our Capital Markets group also provides a strong foundation for organic growth and our market-making activities. We are competing effectively and acquiring more external order flow, and we will continue to ensure we are extracting maximum economic benefit from our retail customer engagement.

Third, as we continue to expand our wealth management offering for long-term investors via existing sales and service channels, we will leverage our heritage of innovation with an eye toward delivering value propositions that redefine the customer experience for self-directed investors. E*TRADE was a pioneer in online trading, and we believe that we have an opportunity to play a similar role in online investing as customer needs and technologies evolve.

Finally, we believe our Bank can play an important role in helping us to optimize the value of our very large and stable brokerage customer deposit base. With a focus on these four areas, which build on our current strengths and in many cases existing assets, we are optimistic about the opportunities ahead.

We are actively executing against these growth strategies, and we'll keep you informed on our progress. As we do this, I assure you that we will remain intensely focused on flawless execution and rigorous expense management. I am gratified to see the energy across the organization as we seize the growth opportunities that lie ahead for E*TRADE.

With that operator, we are ready to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]. Your first question comes from Daniel Harris of Goldman Sachs.

<Q – Daniel Harris>: Hey, good evening guys. How are you?

<A – Steven Freiberg>: Good, Dan.

<Q – Daniel Harris>: I was wondering if we could start on the net interest margin. One of the things that we've seen across the sector is that reinvestment risk is coming to the fore in terms of how you think about loans rolling off and where you're reinvesting those dollars. So can you sort of remind us again how you're thinking about your strategy going forward here?

<A – Steven Freiberg>: Yeah. First, we agree that our preference is to have this basically distinctive upward slope on the yield curve and an elevated level of rates, which clearly has been part of the challenge, which Bruce alluded to during the quarter. That said, we've done several things that helped maintain the, basically the net interest margin, in fact, improved the net interest margin during the period.

First, which I think is strategic for us, we continue to basically grow our margin book, which is actually important. Second, we basically have the opportunity that we've executed on to deploy investment strategies and keep cash at a lower level than we might have otherwise, but sufficient to run our businesses. So cash [audio gap] very little in the overall business.

And finally, we have had the opportunity to basically invest, as you know, in agency-backed securities, which is essentially where we invest our excess as our legacy loan portfolios come down. And I think our, basically our Treasury area has played essentially that role basically smartly and have done very well in that pursuit.

Bruce said on the call three months back, that we would strive to keep our net interest margin in roughly the 300 basis point range. Obviously, there's no precision around 300, but we would say that we have a level of confidence that we will maintain it within that range plus or minus, but we strive to stay relatively neutral on rate moves in either direction.

<Q – Daniel Harris>: Okay. Thanks, that's really helpful. One of the things I've heard you say, Steve, is that you, having spent some time looking through the Bank, there's clearly a good bank within E*TRADE, especially for those clients that are probably bank and brokerage accounts. Have you guys done any more work on identifying that? What's the size of that portfolio? And how would you just think about monetizing that further?

<A – Steven Freiberg>: Yeah. Let me answer for the broader audience that we have, since by my arrival, done segmentation work on what could be described as good bank, bad bank. And without going through a detailed analysis or numbers, as expected, imbedded in the roughly \$17 billion legacy portfolio, there are a large number of customers of E*TRADE that have very good profiles, both in the standpoint of how they look on their own basically set of either I would say, FICO, demographic and other. In addition to that, they've had basically consistent level of payment history with us. And there's absolutely nothing wrong with them, and if we had a choice, we'd rather maintain them longer than shorter.

So that said, now that we have a view of good bank, bad bank, we are looking at and evaluating strategies that might allow us to optimize within, but it's a bit premature to go through any detail related to that, other than to say that the 17 billion or so is not a monolith, and within that there's opportunity. And when we're basically further down line, we'd be more than pleased to have a further dialogue on the topic.

<Q – Daniel Harris>: Okay, great. You know what, I'll step back in the queue. Thanks.

<A – Steven Freiberg>: Thank you.

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

<Q – Richard Repetto>: Good evening, Steve and Bruce.

<A – Steven Freiberg>: Good evening.

<Q – Richard Repetto>: Just a question on the home equity loans, just a slight uptick in the special-mention loans on home equity. And I'm also looking at the allowance on the modified loans, on the TDRs, that's look like the allowance increased 11%. So I guess, can you just comment on where do you think the credit situation is going on with home equity?

<A – Paul Brandow>: Hi, this is Paul Brandow, I'll comment on that. So we are actually overall very pleased with the performance of delinquencies over this year. I think, total special-mention, including both and first lien and home equity, are down in the neighborhood of 25%. You are right, the improvement more recently in home equity has been flatter than first lien; that we expected, because our first lien portfolio was less seasoned, so it took longer time for some of the poor credits to run through there. But where we are now is still believing that we're within this long-term trend, but there will be variability from month-to-month. So you're right, in September, there was what I would call fairly modest uptick, but if you look over the past four, five or six months, the trend has been flattish to down. So I don't think that'll change, but we think the rate of improvement, particularly in home equity, would probably be more moderate. Yeah, sorry.

<Q – Richard Repetto>: Well, just a bit on the TDR allowance for home equity.

<A – Paul Brandow>: On the TDR allowance, the home equity did – the allowances did go up. I don't know where you got 11% from. The valuation allowance, I think went from 50% at the end of the last quarter to 55% at the end of this quarter. That's very much consistent with our experience with regard to delinquencies. And so, while it is up, it's certainly within the range of what we expect – we expected. And our performance with regard to re-delinquencies of modified loans we believe to be considerably better than what we can glean in terms of overall market performance.

<Q – Richard Repetto>: Okay. And then I guess, Bruce or Steve, I think you alluded to this, but the cash that you invested, it looks like on the Bank average enterprise balance sheet that the significant amount of cash was deployed. And I guess, can you just talk about – it looks like it went down on average 2.3 billion out of cash and cash equivalents into, at least a portion of it into, other investments?

<A – Bruce Nolop>: Yes, in fact if you recall in the last earnings forecast that we gave and discussion with you, we talked about one of our goals was to redeploy more of our cash and not to have as much of it at the low return, and we were successful. Frankly, we still have more to go that – it's always difficult to determine how much cash you're going to have to reinvest, and we did have those securities gains. So we ended up with more than we would like, and we still see more upside in redeploying cash into more lucrative investments going forward.

<Q – Richard Repetto>: Okay. And very last quick question. Why isn't the interest expense for the springing lien notes deductible?

<A – Bruce Nolop>: Right. There's really a restriction by the Internal Revenue Service as to how much of high yield debt interest can be deductible. So it's a combination of the rate plus the – to the extent you have original issue discount. And just to clarify, I want to make sure, I said the right number, it's 12 million is the tax that would be due to this non-deductible interest.

<A – Steven Freiberg>: Yeah. Rich, this is Steve, just add to Bruce's comment – commentary that, it's roughly one-third of the interest is not deductible, not the interest rate.

<Q – Richard Repetto>: Yeah.

<A – Steven Freiberg>: And so, it's that third as well as the original issue discount that is getting amortized out, and clearly it's not deductible. Obviously, when the firm was losing money, it was neither an issue and/or obvious. The real challenge is when essentially the profitability is relatively small that the 12 million effect of this gets magnified on a relative basis, which is the tax rate, and over the longer term, assuming the company returns to normal levels of profitability, it becomes relatively mild in its impact.

<Q – Richard Repetto>: Understood. I got it. Good, solid quarter guys. Thanks.

Operator: Your next question comes from Eric Bertrand of Barclays Capital.

<Q – Eric Bertrand>: Continuing on the technical part of the tax, is it 12 per quarter or 12 per year? I heard you say earlier it was annually.

<A – Bruce Nolop>: Yeah, that's correct, Eric. And -

<Q – Eric Bertrand>: so -

<A – Bruce Nolop>: But maybe I can anticipate your question that, the way you do your taxes, each quarter you have to do a estimate of the annual pre-tax income that's taxable and your annual tax payment. And then that gets run through your quarterly statement, and in any one quarter, you can end up with wild swings and the impact. And that was the case this quarter. So – but overall, if you're doing an annual forecast, you should assume 12 million as an incremental tax above and beyond a typical 38% effective tax rate.

<Q – Eric Bertrand>: And that answered the second part of the question; it's cool, thanks.

<A – Bruce Nolop>: And Eric, by the way, congratulations on your promotion.

<Q – Eric Bertrand>: Thank you very much. Getting into the NIM then again, following up on, I believe, Dan's question earlier. Are you suggesting that NIM will not compress if we continue to see the yield curve stay where it is or even compress a little bit lower over the next year or so with quantitative easing?

<A – Steven Freiberg>: No, I think what we said, which is consistent with last quarter, that we expect to have basically a NIM in the 300 basis point range as our goal. We're close to that now, even with the challenges that the industry as well as E*TRADE faced in the second quarter. But in any given quarter, any given period, it could vary from that. And so, we can't guarantee 300. But I would say that we're striving hard to maintain consistency on our spread. And as you recall the 289 did grow to 295, and we're working hard to maintain our spreads, but to the point, we are basically subject to reinvestment risk and the environment, so we are not immune.

<Q – Eric Bertrand>: But let me ask in a different way then. If the rates environment that we have today persists and doesn't change, how much downside is there to NIM as you reprice to the existing rate curve?

<A – Steven Freiberg>: The question's clear. I just don't feel comfortable giving you a quantitative or quantified answer to it. But it, clearly I can tell you directionally in a stable rate environment today, we feel that there is stability in our spreads. Again, it may not be precise, but there is stability

in our spreads. If the environment were to, let's say flatten from here, clearly reinvestment risk is real, and if rates basically were to rise with time, given that the average duration of our portfolio is about 3, 3.5 years, you can get a sense of, in any given period, what we're reinvesting.

<Q – Eric Bertrand>: Okay. I'll squeeze in one more....

<A – Steven Freiberg>: I'm not trying to be difficult on the question, but it's not something I can give you a precise answer to.

<A – Bruce Nolop>: And Eric, this is Bruce, but one other thing to add is that it'll also be a function of to the extent we realize the gains. Because right now we have seen good gains in the portfolio, and we're always making an economic decision as to whether it's best to lock in some of those gains versus having the interest income flow in future quarters.

<Q – Eric Bertrand>: Okay. Lastly on the liability side, your deposit balances and rate continue to compress. Is that still desirable from a capital ratio perspective? Or is this a business decision that you want to continue shrinking your deposit base and your exposure to that very low cost of funding?

<A – Bruce Nolop>: I'd say at this point Eric that we're having the deposits come from brokerage customers, and we're making money on all of those deposits. So, there is not the same desire to reduce the deposits. There's some natural run-off on the Bank side, but you saw that overall customer cash was quite strong; that you had actually an increase this quarter. And from us, for our standpoint that's a good thing, and as we said, we still generated organic capital despite this increase in assets, and that to us is the best of both worlds.

<Q – Eric Bertrand>: Okay, great. Thanks for another profitable quarter.

Operator: Your next question comes from Howard Chen of Credit Suisse.

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

<A – Steven Freiberg>: Hello.

<Q – Howard Chen>: Given all that's going on in DC, just curious any clarity on whether you'll ultimately maintain your thrift charter? Do you envision any shifts to that charter? And with a \$40 billion balance sheet, do you think there's a probability you'll be or a high probability you'll be deemed systemically important?

<A – Steven Freiberg>: Yeah, from the standpoint of our charter, we don't see any either issue or risk to our charter. Obviously, what we do know factually is that the OTS will become an operating arm of the OCC through basically, I think, through the latter part of next year. But that said, our expectation would be that, we are basically a well-capitalized banking institution with a purpose. And that should not basically have any adverse impact as the OTS moves under the OCC. I don't know how else to answer that question. At this point, we have every degree of confidence that we've operated well with our current regulator, and will operate well with whatever the succession plan will be.

<Q – Howard Chen>: Okay, thanks Steven. And just a follow up on that comment with regard to well capitalized, I guess, Dodd-Frank seems to focus a lot on parent company capital. Given your view that you've got excess capital within the Bank, what's the appetite and ability to really upstream that at this point into the parent co?

<A – Bruce Nolop>: At this point, all I can say is that we are at a position with excess capital. We're generating organic capital each quarter. But at this point, I just cannot give you any forecast

as to when we may be able to take money up from the Bank to the parent. It's just – I mean, that's – it's down the road.

<A – Steven Freiberg>: Yeah. I mean just to add to it without predicting. As you'd expect, clearly it's our preference to upstream capital over time, which provides us more flexibility as well as the opportunity to have not only a well-capitalized bank, but a well-capitalized holding company as well. So these are basically areas we're actively engaged. But it's premature to basically bring either specificity to it or prediction, particularly around time. But the issue is one that – that we have as a priority.

<Q – Howard Chen>: Okay, thanks. And then just a final quick one. You mentioned that the income sales this quarter were opportunistic. Could we just get some more color on what exactly you guys sold within the portfolio?

<A – Bruce Nolop>: The simple answer is agency securities; we can do more specifics, if you'd like, but it's all in that securities portfolio, and there's been gains through the spreads narrowing, in general.

<Q – Howard Chen>: Okay, we'll follow-up offline. Thanks so much.

<A – Bruce Nolop>: Yeah.

Operator: Your next question comes from Michael Carrier of Deutsche Bank.

<Q – Michael Carrier>: Thanks guys. Just one – thanks for the detail on the future plans, and areas to focus on, it's helpful. Just on that point, just when we think about the balance sheet, it has been running off about a billion a quarter. Is that still sort of an expected run rate in the near-term? Or just if you do get deposits in, would you be keeping it at a certain level, more from just a forecasting standpoint.

<A – Steven Freiberg>: Yeah, I think the best way to think about it is the legacy asset portfolio should continue to run-off at approximately \$1 billion a quarter, although not in perpetuity, and obviously, the portfolio gets smaller, they'll be sort of kind of relative adjustment to that. But I'd say that the trend has been approximately 1 billion a quarter and probably holds for a while, then diminishes in absolute dollar terms just by nature of size of the portfolio.

On the other side, kind of basically picking up on Bruce's commentary, that we would expect and strategically want to grow our consumer deposit base, particularly our consumer deposits coming from our brokerage business. That said, as those deposits grow, and they have been growing, we probably will diminish, which is what we have been doing as well continue to do, is wholesale funding. And hopefully, we will grow the business. And I think the balance sheet over the longer term will be more determined by the size of our customer deposits, strategic customer deposits than anything else, and we'll adjust the asset side of the balance sheet accordingly. So, hopefully, with time legacy assets come down, wholesale funding comes down, consumer deposits go up, and we'll build the asset side of the balance sheet in accordance with the size of that deposit base.

<Q – Michael Carrier>: Okay. Thanks, it's helpful. And then just one more on the, I guess, on the capital side. We think about – if you had either like a target for the holding company, just because if we think about whether the amount of capital in the Bank, the earnings generation, the DTA benefit, you could kind of back into it. But just – I don't know if you guys have some sense or maybe you will in a few quarters down the road, if you get more clarity. But just wanting your thoughts on that, because there are a lot of moving pieces....

<A – Bruce Nolop>: Yeah. At this point, we're monitoring what the regulatory requirements are going to be. But in general, the only thing we know for sure is that there'll be similar ratios to what's

applied to the Bank, and so we're already just making sure that we have forecasted good Tier 1 capital as a percent of total assets, and good Tier 1 capital as percent of risk-weighted assets. And we also pay attention to tangible equity, as another ratio that makes sense. We haven't set specific targets, but from all of the commentary we've seen about potential goals that may be set by regulators, we feel very confident that over time we should be able to maintain and fulfill any requirement without the need for external capital.

<Q – Michael Carrier>: Okay, that's helpful. And then just on expenses, continue to trend down and you guys are finding ways to take it down. This quarter you have some seasonality. I guess, just going forward, ex maybe the lift-up in advertising that we typically see, anything unusual there or any other lay-downs from other initiatives that are in place?

<A – Bruce Nolop>: At this point, we think relatively constant expenses. There would be some mix changes, as we've talked that more emphasis on customer-facing and customer service people as opposed to back office people. But the heavy lifting on the overall reduction expenses has occurred and there'll be more just, as Steve put it, managing our expenses to make sure that we don't increase them as our profitability improves.

<A – Steven Freiberg>: Yeah. And just to add to that, kind of general, basically the general mode of operation for us is going to be is, as quick as we can, is to redirect expenses into growth opportunities, both short and medium-term, and hopefully, that will basically enhance the trajectory of the business. So it's not so much expenses as an aggregate, they're clearly good expenses and bad expenses. We want to make sure that we have an overabundance of good expense in the business and really drive down the expenses that are not adding value or distracting, are hobbies.

<Q – Michael Carrier>: Okay. Thanks guys.

Operator: Your next question comes from line of Mike Vinciguerra of BMO Capital Markets.

<Q – Michael Vinciguerra>: Thank you. One more thing on the interest income. Bruce, I just want to make sure I understand that the corporate interest income this quarter was a positive 6 million. Is that the number you're talking about in terms of reinvesting the corporate cash, because I think that's excluded from the enterprise and interest-earning assets, isn't that?

<A – Bruce Nolop>: That is, no, they're really two different topics. There is one, which is corporate interest expense and that had a credit from the legal settlement. The prior discussion was on our net interest spread, and that referred to cash primarily in our Bank. And so, that would not be affected by that credit.

<Q – Michael Vinciguerra>: I understand. Okay, thank you. And then on the drop in your attrition rate at the brokerage, obviously, pretty impressive from 13 to 10, can you quantify at all how big an impact the fact that you guys – you basically started waiving IRA service fees and account service fees, I guess, the first and second quarters? Has that been – played a role because you're not pushing people down below the \$25 minimum on your own, they're just kind of staying in lower balance accounts?

<A – Steven Freiberg>: Yeah, I mean, this is Steve, again. Clearly, it's not one element that has, that's driven down the rate, but clearly, that's been helpful. I think simplifying our pricing, basically taking off the inactivity fees. But I think more importantly, when we measure essentially the service satisfaction of our client base that's been on a constant, or basically a constantly improving track. Net Promoter Scores, which essentially is how people feel, not only about the firm, but willingness to recommend us to others, that's been improving as well. Plus we've been enhancing both product as well as the utility, which is our platform.

I think it's really kind of the aggregation of all those pieces that have brought the attrition rate down to what has been a goal for the company. And also actually quite, I think, an impressive march from where it had been, if you look back over the last, I would say, six quarters or so to where it is today.

As I said in the opening commentary, our expectation is we'll strive hard to maintain it; I'd like say is we'll tried hard to improve upon it to get into the single digits. But it's a big deal when you have 2.7 million brokerage accounts, every 1% is a lot of accounts, think about it in essentially numeric terms. If you think about 1%, it's 27,000 accounts, how much we'd spend to get 27,000 accounts.

So, what we're trying to operate on, not only is the front-end bringing on new customers, but bringing on new customers, really maintaining the relationship we have with our existing customers, and importantly, broadening out the relationship we have with existing customers so that we could help them further, and we can derive more benefit as they derive basically more utility from what we offer. But it's all wrapped together.

<Q – Michael Vinciguerra>: Right, right. And to a comment you made before, Steve, on the Stock Plan business being a key driver to your new accounts. Can you actually quantify how important that's been to helping drive the gross new accounts coming out of it? What percentage comes from that business?

<A – Steven Freiberg>: Typically, and it varies a bit, but typically 20 to 25% of our new retail accounts come through that stream. And so in a world where everyone has limits to resources, that has become a very high priority for us, one, to grow the business, because on its own, it's compelling. But more importantly, it's one of the best sources of good quality new customers that we have, and we have a very strong presence within that space. And in addition to that, it was probably the largest single capital expenditure this company has made over the last 2.5 years, was to completely upgrade its capabilities and platforms as well as its people. And it's been recognized externally, and we see it as an important lever to grow the business, and we're very excited about it, and we're working very hard on that aspect as we speak.

<Q – Michael Vinciguerra>: That's great. Thanks, very much.

Operator: Your next question comes from Matt Snowling of FBR Capital Markets.

<Q – Matthew Snowling>: Yeah. Hi, good evening.

<A – Steven Freiberg>: Hi, Matt.

<Q – Matthew Snowling>: I just have a follow-up question for Steve on capital. Once you are actually able to upstream the capital, can you give us a sense as to what your views are and how do you'd allocate that? I guess what I'm asking is you have debt that's callable next year.

<A – Steven Freiberg>: Yeah.

<Q – Matthew Snowling>: And one could argue that the stock's looking pretty attractive on normalized earnings. And how do you weigh that versus kind of Basel requirements?

<A – Steven Freiberg>: Yeah. I guess, we look at it on I would say on a hypothetical, because clearly, we haven't upstreamed the capital at this point. But if we were to upstream capital, we think about it as potentially having three, let's say three uses. One is, we want to basically grow the business and how much capital is required to grow the business, although largely this is not a highly capital intensive business. Second to your point, we have a sizeable amount of high-priced debt out in the marketplace. And if we could retire some of that debt, that would be a good thing, because we spend pretty close to \$170 million or so a year in servicing that debt, which was brought on largely when the company was stressed and needed to be recapped. And then finally,

to your point, we would basically look at alternatives, including the potential to buy back our own equity or stock.

But it will be situational, so when the events occur, it's hard to predict which would have the highest priority. But I think the universe is reasonably well-defined as to what we might deploy that capital towards. So I'm not evading, but I can't answer the question until I get to the point where I actually have the capital from the standpoint of flexibility, but also understand the situation at that particular point in time.

<Q – Michael Vinciguerra>: Fair enough.

Operator: Your next question comes from Faye Elliott of Merrill Lynch.

<Q – Faye Elliott>: Hi, thanks for taking my call.

<A – Steven Freiberg>: Thanks, Faye.

<Q – Faye Elliott>: Could you just revisit the TDR allowances and the shortfall to the expected losses? I know there's a footnote there that suggests that the expected losses do include charge-offs that you've already taken. If you net out your expectations versus what your expected losses are, do you come out ahead on the allowance?

<A – Paul Brandow>: Let me give a try at that answer; it's Paul again. So if you're looking at the exhibit in our press release, you are right. There are two columns; one's a specific allowance as a percentage of the loans.

<Q – Faye Elliott>: Right.

<A – Paul Brandow>: And one is a total expected loss. The difference between those two numbers is due to the fact that at 180 days past due, we write all of our loans down to expected recovery value. So basically the difference between those columns is that. The penultimate column, the specific valuation, represents the reserve we have for the remaining losses we expect to take on those loans, and that allowance, we do believe, is sufficient to cover those losses.

<Q – Faye Elliott>: So, basically the specific valuation allowance is enough to cover your residual expected losses?

<A – Paul Brandow>: Yes.

<Q – Faye Elliott>: Okay. So we don't need a true-up there, shouldn't be expecting one?

<A – Paul Brandow>: No.

<Q – Faye Elliott>: Okay, great. And then, other of your peers have suggested that they might kind of re-enter the lending game, given reinvestment risk and so forth. Is this something that down the road you could consider? I know that they were brokered loans before, so that might involve a larger business build than you have in mind. But since you have the Bank, would you consider getting into the lending game again?

<A – Steven Freiberg>: This is Steve. Let me try to provide perspective to that. The business that E*TRADE had been in, which is predominantly the purchase of whole loans and securities, is a business that we would not re-enter, definitively would not re-enter, other than to qualify agency-backed MBS is fine.

From the standpoint, more broadly, would we like to lend money to our high-quality brokerage customers? That's a different issue and one that we are basically assessing. So simply stated, we have a margin book as we said that's approaching 5 billion. Would I like it to be twice the size? The answer is yes. We'll be deploying additional product and capability, as I've mentioned, over the coming quarters, hopefully, giving us an opportunity to grow that further.

And then taking a step back, the universe that we're quite interested in is largely the one that is the core of our business, the 2.7 million brokerage customers. And we'll assess whether or not, we're not saying we would, but we'll assess whether or not that is a business that we'd want to enter. If we would enter the lending business, it would be very much focused on that client base, which is a very different animal from where we've come, expectation being a relational-oriented business to a high-quality base of customer could provide us an opportunity. But it's something that we're thinking about, but we don't have specific plans to pursue.

<Q – Faye Elliott>: Right. Understood something that would – where you have insight into the customer's financial health, and so, you would probably, if you did it, feel comfortable with their abilities to cover their obligations and so forth.

<A – Steven Freiberg>: Correct.

<Q – Faye Elliott>: Okay. That's all I have, thanks so much.

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

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

<A – Steven Freiberg>: Hi, Patrick.

<Q – Patrick O'Shaughnessy>: Steve, in your prepared comments you talked a little about some of your new growth initiatives, and one that you touched on was advisor-based managed portfolios. I was hoping you could provide a little bit more color on that. And then just address the bigger issue where if you look at some of your – the larger competitors in the space, the firms that are growing the client asset the fastest, certainly have the advisor businesses. So, kind of how do you think about maybe trying to establish a bigger beachhead into that area?

<A – Steven Freiberg>: Let me answer both, and Mike Curcio is here, who runs the brokerage side, and Mike should feel free to add his comments as well. On the RIA business, it hasn't been a business that we've been in, in the past, and our business model really has been one that's direct to the customer. And so not disagreeing that it's a fast or growing segment of the broader industry, it just hasn't been an area that we've pursued. So it's something that, again, we would consider, but in a world of prioritization, it's not high on our list of our priorities, at least over the near to intermediate term.

In contrast, for example, we would much prefer to rev up our Corporate Services group and grow more rapidly there than basically enter an area that is costly to enter and will take a long time, in our view, to get aggregate profitability. So we just have to be conscious, not only of the opportunity, but the cost of entry, and what our alternatives are. And again, because it wasn't central for the business model over time, I'll never say, never, but I don't want to mislead anybody to say that we're going to jump into that area.

From the standpoint of the managed investment products and the like, I'll let Mike comment on that as to what we have in the marketplace, how we basically have distributed those products, and what some of the near-term opportunities are in that particular space, as we try to basically service both the investment needs of our clients, in addition to what we've historically done, which has been predominantly the trading needs of our clients.

<A – Michael Curcio>: Thanks, Steve. This is Mike. On the MIPs or managed investment portfolios, we first started with a very simple RAP, ETF and mutual fund accounts that were expanded to – we will be extending it to separately managed accounts in late Q4, early, Q1 of next year. What we've seen is a tremendous appetite from our customer base; we're hitting our target numbers. And in conjunction with the rapidly – rapidly, excuse me, expanding sales force, we're very optimistic of a lot more penetration in assets in MIPs, as well as our mutual funds business overall.

<A – Steven Freiberg>: Yeah. Let me just go back just to add to the commentary, because it may have been missed, it's what I've said in my opening comments that we've worked through a segmentation of our portfolio, and in our basically, I would say, in our most compelling segments, what Mike and team have been doing is adding relational sales capability.

And in the addition of the relationships – relational sales capability, the products and services that would better serve, not only the trading needs, but the investment needs of our customers as well. And it's a fairly virtuous cycle that they basically broaden their relationship with us, we can fulfill more of their needs. But in addition to that, we can begin to diversify from just the transaction orientation on the brokerage side to one that gives us an actuarial stream in addition, because of essentially the management fees that come along with those particular products.

<Q – Patrick O'Shaughnessy>: Got it. Appreciate the clarification, and that's all I had.

<A – Steven Freiberg>: Thanks.

Operator: Your next question comes from Brennan Hawken of Collins Stewart.

<Q – Brennan Hawken>: Hi guys, thanks for taking the question. In 2Q, you put back about 20 million to sellers and mortgages. And so, I was hoping that maybe you could give us some color on how further put-backs are going? And also if maybe you could clarify, I know a great portion of your loans were purchased from third parties. And so, if you could maybe give some details on who those originating parties were? And what the standard practices are on put-backs, whether they were brokers or banks or what have you?

<A – Robert Burton>: Sure. This is Bob Burton, I'll answer that one. We've been very aggressive since 2007 in putting back loans to customers. We've put back about \$263 million of loans so far. Obviously, as the loan portfolio ages, our opportunity to put those loans back becomes somewhat smaller. But we continue to work with the original sellers to put back loans to them. We've done about 40 million this year, so it is slowing down. But at the same time, we are also talking to a variety of original sellers about settlements of that right, and there's some opportunity there.

In terms of who the sellers were, it really cuts across all of the people that were heavy originators of loans during that period. And so, there's no particular concentration in any one originator, it really is pretty indicative of the market during those years.

<Q – Brennan Hawken>: Fair enough. Thanks for the clarity.

Operator: Your next question comes from Joel Jeffrey of KBW.

<Q – Joel Jeffrey>: Good afternoon, guys. Could you just – it looks like DARTs clearly were down in this quarter. Just wondering if you get a sense, given that volumes have picked up again, how they're trending so far in the fourth quarter?

<A – Steven Freiberg>: Yeah. Let me – this is Steve again. Let me just kind of give perspective without again giving numbers. Clearly, the industry-wide softness we experienced, we think we're

in line with basically with expectations. That said, the early part of the fourth quarter, really the basically the first 20 days or so of October, we've seen basically a fair amount of resiliency in trading activity without getting into specificity.

So we're not declaring basically that it's the point of inflection, post the flash crash, but on the other hand it does make us feel a bit more confident that the, I would say, the retail client or the retail customer possibly is feeling well enough to wade back into the maybe the shallow end of the pool. But that said, it's still very early days, but I'd rather be seeing the trend we're seeing in the first part of the quarter, than not. I don't know if that answers it, but that's the best we can say at the moment.

<Q – Joel Jeffrey>: Close enough, I guess.

<A – Steven Freiberg>: Yeah.

<Q – Joel Jeffrey>: Can you just give us a sense, though, for the last quarter what percentage of your DARTs came from options and ETFs?

<A – Steven Freiberg>: Yeah, approximately 18%.

<Q – Joel Jeffrey>: Was that options?

<A – Steven Freiberg>: The option was 18.

<A – Bruce Nolop>: 11% was ETF.

<A – Steven Freiberg>: Yeah, so let's say just short of 30 on the two components.

<Q – Joel Jeffrey>: Okay, great. And then just lastly, I know you usually disclose this in the Q, but just wondering if you guys had the updated loan-to-value numbers for the one-to four of the HELOC portfolios?

<A – Steven Freiberg>: Not, not at this point.

<A – Bruce Nolop>: It will be in the Q.

<A – Steven Freiberg>: It will be in the Q.

<Q – Joel Jeffrey>: All right, great. Thank you.

Operator: This concludes the allotted time for our question-and-answer session. I will now turn the floor back over to Steve for any closing remarks.

Steven J. Freiberg, Chief Executive Officer

Thank you, again, for joining us tonight. We look forward to speaking with you again next quarter. And good evening.

Operator: Thank you. This concludes your conference. You may now disconnect.

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