MANAGEMENT DISCUSSION SECTION

Operator: Welcome to E*TRADE FINANCIAL Corporation's second quarter 2006 earnings conference call. At this time all participants have been placed on a listen-only mode. Following the presentation the floor will be open for questions. I've been asked to begin this call with the following Safe Harbor statement.

During this conference call the company will be sharing with you certain projections or other forward-looking statements regarding future events or its future performance. E*TRADE FINANCIAL cautions you that certain factors including risks and uncertainties referred to in the 10-Ks, 10-Qs and other reports it periodically files with the Securities and Exchange Commission could cause the company's actual results to differ materially from those indicated by its projections or forward-looking statements.

This call will present information as of July 19th, 2006. Please note that E*TRADE FINANCIAL disclaims any duty to any forward-looking statements made in the presentation. In this call E*TRADE FINANCIAL may also discuss some non-GAAP measures and talking about its performance and you can find the reconciliation of these 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. Replace of this call will be available via phone, webcast and by podcast beginning at approximately 7 p.m. eastern time today through 11 p.m. eastern time on Wednesday, August 2nd. The call is being webcast live at www.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

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

Mitchell H. Caplan, Chief Executive Officer

Thanks everyone for joining us today. Just over three years ago we set out to redefine our target market and measure the corresponding opportunity ahead of us. While many questioned us at the time we strongly believed that running mono-line brokerage or bank businesses was not the best approach to truly connect with the retail customer and deliver long-term shareholder value.

We believed that the right model was to create complete integration between brokerage and bank and then to run the entire company off of an integrated technology operations and service platform globally. By doing so, we believed that we would eventually create a franchise that would generate a high return on each incremental dollar of revenue irrespective of whether it was from trading, assets, cash or credit.

We have spent the last three years executing on this strategy, and today we are there. The model has clearly reached an inflection point, generating superior returns for shareholders by delivering value to customers through relevant, value-based financial solutions in any given macro economic and geopolitical environment. Getting to this point required hard work and some tough decisions. We evaluated our model and the strength of our value proposition to ensure that we were well-positioned within the global financial services marketplace. With respect to the model, we realigned our operations and management structure around customer segments. Further, we divested or exited non-core businesses improving consolidated profit margins and allowing us to focus on building our core franchise.
We took the improved profits of the company and delivered enhancements to the financial solutions for our customers and value to shareholders through earnings growth and additional share repurchases, translating into improved return on tangible equity.

With respect to enhancing our value proposition we took a multistep, multiyear approach. We first focused on price to get back in line with the competition and to begin to differentiate based on our customer segmentation strategy. Over the past few years we have adjusted pricing across cash, credit investing and trading products. We did so in a way that ensures we deliver compelling value on a product-by-product basis and in the aggregate through bundled offerings. The changes we have made more effectively align value with client engagement, rewarding customers for increasing asset levels, transactional activity and overall revenue contribution to the company. We continue to feel very good about how we are positioned on price.

We then turned to functionality and made significant enhancements across our entire suite of products. These enhancements culminated in the launch of E*TRADE Complete which now includes a set of industry leading tools designed to help customers optimize their investing, trading, banking and lending relationships.

Having significantly strengthened our value proposition around price and functionality we most recently increased our focus on the third component of the value proposition, service. As we stated just last quarter, we are investing in additional $42 million this year to enhance our service organization and to significantly increase quality levels. This investment is integral to a series of initiatives we have launched to lower attrition levels, increase overall account quality and ultimately build a stronger franchise.

We also recognize that to deliver consistent and superior performance we must maintain an operating structure that is flexible in the short term without sacrificing our long-term growth opportunities.

The flexibility of our operating structure and the relevance of the suite of products it supports proved itself during a highly volatile second quarter. During this past quarter broad macro economic and geopolitical concerns such as inflation, rising interest rates, oil prices and continuing conflict in the Middle East caused instability throughout the world's markets. The Dow Jones Industrial Average hit a six-year high only to give back all of its gains for the year. Emerging market indices, which had significantly outpaced the U.S. for some time, fell precipitously. Investors quickly looked to reduce risk in their portfolios and eventually stepped away from the market resulting in a sharp industrywide decline in June trading activity.

At the same time, we saw high volatility in the fixed income market with the yield curve steepening early in the quarter and then inverting by mid quarter. We saw customers begin to look at cash as an offensive investment option and deploy excess liquidity in the deposit products in search of a safe haven with an attractive return. While our model enjoys all the leverage and operating benefits during a strong economic environment, it is precisely in these volatile macro economic conditions that we outperform and stand out within the industry.

While many in the financial services sector struggled in the second quarter we generated top line growth while reducing total operating expenses. This combination translated into another quarter of record earnings and operating margins. Total revenue increased to a record $611 million, driven by continued growth in cash and credit relationships as an offset to declining trading volumes. Through greater scale and efficiencies, core operating margins, excluding acquisition related integration expenses, was steady at 44%, and including these expenses, increased to 43%. Well on its way to our goal of 50%.

Pretax income increased to a record $242 million, including approximately $8 million or 1 cent per share of deal integrated related expenses as we previously guided.
On the bottom line, we delivered record earnings of 37 cents per share, excluding these integration expenses, or 36 cents per share on a GAAP basis. Our model was tested once again and it differentiated itself once again, this time by performing in highly challenging global economic conditions. We remain extremely pleased with the performance of the business, and its ability to deliver these superior results.

As we continue building our franchise globally we will focus on strengthening the banking, lending and investing components of our value proposition.

Delivering relevant and timely financial solutions to the tens of millions of global wealth building customers will drive organic growth in accounts, deeper customer engagement and increased total profitability of the model.

We will also continue to seek consolidation and partnerships within the global financial services marketplace when we see an opportunity to turbo charge these growth initiatives.

Now, to provide further details on the success of our operations and the specifics of the quarter, I would like to turn the call over to our President and Chief Operating Officer Jarrett Lilien.

R. Jarrett Lilien, President and Chief Operating Officer

Thanks, Mitch. As we always say, at the center of our business is the global retail customer. Through our integrated model each action that we take in executing on our plan is designed to enhance the customer experience, drive further customer engagement and then propel retail results that can be leveraged through our institutional segment to fully maximize shareholder value.

So how did we execute in the second quarter? In a volatile market filled with uncertainty as Mitch described, we generated superior results, while at the same time successfully completing the account conversion of BrownCo in early May.

Net new account additions increased 58% versus a year-ago period to 41,000. This increase was driven through a combination of new customers, and broadened engagements with existing customers. We are pleased with the continued growth in our mass affluent and active trader segments. In fact the account growth within these segments is trending at a 30% annualized rate. More importantly we drove this net new account growth despite the heightened pace of attrition to be expected as we move through the final phases of the Harrisdirect and BrownCo integrations.

We also saw the highest level in three years for new deposit and lending account openings, precisely what we would have expected to see in an environment with increasing focus and attention on cash and lending products. One of the clear benefits to us of the changing market dynamics is the interest in cash as a deposit product. Balances in our deposit products increased by $1.7 billion this quarter, as customers began taking advantage of the higher returns in a rising rate environment. Sweep was up $400 million, transaction accounts were also up $400 million and certificates of deposit were up $900 million as the market turned lower we saw customers proactively deploying excess liquidity into deposits as an offensive portfolio move.

Customers also continued cash accumulation across our deposit products. On a gross basis enterprise customer cash increased by approximately 1 billion in the second quarter. Against this growth increase were two anticipated offsets. The first was seasonal outflows of approximately $250 million related to taxes, the second was approximately $400 million of outflows related to model deal attrition from the Harrisdirect and BrownCo transactions. Considering the impact of these two factors our 1.7 billion in new deposits and $300 million of net new enterprise cash growth demonstrates that we continue to be a destination for our customers’ cash.
Having developed an integrated cost-effective model that anticipates and delivers timely and relevant solutions to our customers' needs we stand uniquely positioned to benefit from customer’s increased focus on cash products. And just as we believed several years ago that cash products would become a greater interest as a form of asset allocation, we are now entering a period where we believe compelling lending solutions will gain greater attention.

In discussing our credit solutions we delivered another quarter of solid balance sheet growth with average interest earning assets increasing by $2.7 billion or about 7% sequentially. We accomplished this while continuing to adhere to the same strict discipline the bank has employed for the last 17 years with respect to both interest rate and credit risk management. As a result of our ability to grow the balance sheet in the current rate environment we were able to take advantage of rising rates on credit products funded by growth and customer cash balances.

While many of our competitors saw compressing interest rate spreads, the average yield on our assets increased by 31 basis points sequentially while the cost of our liabilities increased by only 26 basis points, the result a 5 basis point increase in our net increase spread. By leveraging technology and our integrated balance sheet we see a unique opportunity create and deliver interesting value-oriented credit products to retail customers. The launch of our Intelligent Lending Optimizer earlier this year is the perfect example. We will use technology solutions like the Optimizer to drive greater awareness of the credit products we offer thereby helping customers to more effectively manage their borrowings. By having the vision to stay ahead of the curve we will continue to offer the most relevant value proposition.

In our investing solutions we continue to execute on our strategy on multiple fronts. We furthered our regional advisor initiative with the announced acquisition of Retirement Advisors of America, an investment advisor with over $1 billion in assets under management. This transaction enforces our commitment to providing a full continuum of services to our customers as they build wealth. We also continue to deliver on our promise as being a customer advocate.

In the second quarter we made our largest rebate of 12B-1 fees putting nearly $2 million in the pockets of our mutual fund investors. In trading, volatility in the equity markets resulted in the general slowdown across the industry although total DART volumes declined 9% sequentially in the second quarter, they doubled over the year ago period through the benefits of continued growth in accounts both organically and through acquisition. International trading activity continued to outpace domestic volumes, actually increasing 5% sequentially.

Our international operations continue to be a strong growth contributor within our retail trading business and over time will become a significant contributor across our entire model. Through the success we are experiencing internationally, we are now looking to extend our banking and lending solution into many of those markets.

An additional positive trend imbedded in our trading results was the outperformance of option volumes relative to equities. Option related DART further increased as a percentage of our total U.S. DART volumes to represent 12.4% of volumes versus 12.2% last quarter and 10% a year ago.

Continuing our leadership in trading functionality we announced this morning a set of enhancements to our retail platform for both equities and options. Within these enhancements we have added a series of conditional order types such as trailing stocks for options. These new features will allow customers to employ hedging strategies or simply allocate their investing dollars among the most attractive investments given evolving market conditions. Features such as these and our order execution quality, which was recognized earlier this year by an independent research firm as one of the best in the industry, are reflective of our view that the battle continues to be less over price and more over functionality and service.
Finally, I would like to provide a quick update on deal attrition. Given that we have fully completed the conversion and integration of both Harrisdirect and BrownCo, we believe that we have passed the peak attrition period for both transactions. This will be our final update to these attrition statistics as both customer bases are now fully integrated into our core.

As of June 30th, economic driver attrition had flattened out at 10% for Harrisdirect and 5% for BrownCo. We are very pleased with both outcomes given that our modeled attrition for each transaction assumed 15% economic driver attrition.

Further we are pleased to announce that we have now achieved over 98% of the expense synergies related to these transactions. This is ahead of the original timeline, and coupled with a lower attrition level a key contributor to the strength of our customer metrics and our economic outperformance through the first half of the year.

With that I will turn the call over to Rob for the financial details of our results.

Robert J. Simmons, Chief Financial Officer

Okay. Thanks Jarrett. Our continued run of record results build on our first quarter momentum, our execution within our core model and on the integration of our acquisition. During the quarter we remained focused on execution driving top line growth while managing expenses, proving the flexibility and benefit of multiple revenue touch points with customers. Second quarter total net revenue increased 2% or $13 million sequentially to a record $611 million. We delivered this increase despite an $8 million decline in retail commissions from weaker trading volumes consistent with the industry. Retail commissions represented 21% of total net revenue down sequentially from 23% in the first quarter. Net interest income after provision increased 6% sequentially to a record $334 million.

The increase in net interest income was the result of both a larger balance sheet and further net interest spread improvement as we benefited from higher asset yields, continued growth in customer cash and strong credit metrics. Net charge-offs declined to 15 basis points from 18 basis points in the prior quarter, a proof point of the high credit quality and conservative product mix of our portfolio. Mortgage and home equity receivables increased as did margin debt balances while the consumer loan portfolio continued to roll off as planned.

Looking at expenses, we continue to exercise prudent control and deliver efficiency across our operations. Total operating expenses excluding corporate interest were down 1.1% sequentially to $351 million. Included in the expense base was approximately $8 million of acquisition integration related expenses as previously outlined.

We continue to expect these deal-related expenses to remain about 1 cent in the third quarter before dropping to zero in the fourth quarter for an annual total of 5 cents. Through efficiency and cost controls each of our operating expense line items were flat to down, as a percentage of revenue in the quarter, demonstrating the leverage in the model. Compensation and benefits increased $9.7 million but still held at our target of approximately 20% of revenue. This increase was primarily the result of the additional salaries from our planned service investment of approximately $8 million in the quarter. Marketing spend was down just over $4 million quarter over quarter to $30.4 million, remaining consistent with the range set forth in our original guidance. We will continue to prudently allocate the marketing spend among our suite of products in relation to current market dynamics. In this past quarter, we continued to invest in marketing areas such as cash and credit solutions to wealth building customers and in international markets while reducing our spend for domestic trading solutions. With revenue up 2% and total operating expenses, excluding corporate interest, down 1%, operating margin expanded to 43% from 41% in the prior quarter and 36% a year ago.
In addition, we achieved a new milestone this quarter, generating over $300 million in EBITDA for the first time in the company's history. Also during the quarter we were pleased to learn that our improved profitability and demonstrated stability of the model had been recognized by Moody's Investor Services, a leading credit rating agency. Moody's upgraded our bank credit rating by 2 notches to investment grade and also upped our corporate rating by 2 notches. This marks an important acknowledgement of the progress we have made as a company.

The broad-based market volatility in the second quarter provided a window for us to opportunistically continue with our share repurchase program. During the quarter we purchased in the open market approximately $48 million of stock or about 2 million shares at an average price of 23.79 per share. After this purchase activity we have $131 million still available on our board-approved share and debt repurchase program. We will continue to balance leverage targets and growth opportunities against the value created by buying back our debt and equity securities.

Finally, as we typically do at this point in the year we have gone back and re-visited the key driver assumptions and bottom line earnings forecasts that we established previously. Given the strong performance we have delivered year-to-date and taking into consideration the current trends we are seeing, including the final deal attrition levels, we are comfortable raising and narrowing our guidance range at this time. We are raising the low end of the previous range by 7 cents and the high end of that range by 2 cents. Thus tightening the overall range to our new EPS outlook of $1.42 per share to $1.52 per share. This range excludes the expected 5 cents in deal related integration expenses that we previously outlined. Including these expenses, we now expect to earn about between $1.37 and $1.47 in GAAP EPS. A table containing the revised range for each of the key earnings drivers is included in today's press release.

In conclusion, we are pleased with the company's performance and our model's flexibility through volatile market conditions. We remain focused on building an integrated global franchise to deliver superior shareholder value over the long term.

With that, Operator, I would like to open the call to questions.
QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]. Your first question is coming from Mr. Rich Repetto with Sandler O'Neill. Please go ahead.


<Q – Richard Repetto>: Mitch, the first question is on the cash side, you know, I can see the benefit of the deposit, the increase in the deposit, the 1.7 billion increase in the deposits. On the cash that's, it says including money market funds that's the side it looks like it decreased. And I'm just trying to see, you know, where would we see the impact there of a cash decrease in fees or – I'm trying to just understand, you know, how the cash here plays, drives the income statement.

<A – Mitchell Caplan>: Yes, you are right. So as you see it move over onto the balance sheet as a deposit product, it shows up in net interest income and it is part of spread. And then to the extent that it is just fees that we're receiving on third party cash that's going out or otherwise, that may show up in fees. Right? And then there is also a part that gets consolidated on our overall consolidated balance sheet separate from the bank, which would show up in net interest income as well. But let me bridge you through the quarter because it I think it will help.

One of the things that we were able to do is bring over 1.7 billion on to the consolidated balance sheet, and that was meaningful in helping to drive the 5 basis point increase in spread in the quarter. By and large what you saw was about 31 basis points up on asset yields and about 26 basis points up on cost of funds, which resulted in the 5 basis point spread. Part of the reason why you were only up 26 basis points is because you were able to grow that cash on the balance sheet, which is very cost effective for us not only from a rate perspective but also obviously from duration characteristics, as we have talked about. When you think about enterprise cash, that's the overall cash that came in. We brought in I believe about 900 million, 800 million about three or four quarters ago then it was about a billion, a billion six. This past quarter it was about a billion when you look at the organic number. And then we lost about 250, which you would not typically lose in a quarter related to tax and tax payments. And then we had excess attrition in the quarter related to Harris and Brown, which accounted for about another 400 million of outflow that you would not otherwise expect to see.

So as you look at our earnings guidance that we just gave you for the year at $1.42 to $1.52. And you look at the enterprise cash, what you will see is imbedded in those numbers is that we presume in the second half of this year on the low end, we will bring in somewhere about 1.7 billion in new enterprise cash and on the high end about 3.8. And given what we have historically seen over these last four or five quarters, given what we are currently seeing in the marketplace in terms of levels of interest of cash of the product I think we feel very comfortable with those ranges to the extent the opportunity is greater and we exceed them then we will come back and re-visit again at the end of next quarter. But given what we are seeing now I think we put a prudent range around enterprise cash for the rest of the year.

<Q – Richard Repetto>: Okay. Because I looked at these – your fees increased in every category as well so –


<Q – Richard Repetto>: Okay. Then I guess the next question is, and I think I know the answer from what Jarrett's prepared remarks. On the expense side, you know, if you look at, you know, all of the expenses from marketing, professional services, communications and the other expenses,
you were down 18 million in aggregate, around quarter to quarter. And I guess that's the indication of the faster integration.

<A – Mitchell Caplan>: That's right.

<Q – Richard Repetto>: And then now we do see an offset with comp going up. Is that the increase of the headcount on the service side, I guess?

<A – Mitchell Caplan>: It is. It absolutely is. So there are two numbers if I remember correctly that went up in the absolute quarter over quarter. One was comp and benefits and the other was the servicing expense. Obviously in the clearing and servicing as the size of the balance sheet grows you have more servicing expenses, because you are absolute dollars are growing on balance sheet and so that is an increasing number. Although I think we are continuing to gain efficiency with that number both around percentage of revenue as well as the actual cost associated with servicing.

On comp and benefits, we guided, when we guided at the end of Q1 to our numbers we said we were going to make an additional $42 million investment in service this year. 8 million of that is showing up this quarter and it is showing up really in the comp and benefits related to service. The other 1.7 million for the total of 9.7 million is really frankly related to bonus accrual. We are doing quite well as a company and we are continuing to accrue bonuses accordingly.

<Q – Richard Repetto>: You mean you are not pulling back bonus accruals this quarter. That's a joke.

<A – Mitchell Caplan>: Yeah, yeah. No, we are just accruing based on performance.

<Q – Richard Repetto>: I gotcha, and the very last thing, Mitch. There is all this attention right now on people shopping for high, you know, with the interest rates where they are, on higher cash rates, moving deposits around, and looking, you know – it seems like you were focused on cash a while back. I'm just trying to see the positioning of E*TRADE, you know, as an enterprise sort of financial, integrated financial service as people, you know, do get more cognizant of cash and the rates, how do you think the end results will be for you?

<A – Mitchell Caplan>: Yes. I hear you completely. So I think you are right. I mean, hopefully we were ahead of the curve. We started talking about cash a couple of years ago, and I believe that the next sort of real interesting opportunity is not only with cash going forward but also on the credit side. And I think you are going to be able to see us over the long term continue to be in a place where we benefit from not only engagement with customers around cash. And what that cost of funds is for us but as well engaging with customers in the [inaudible] credit products. We are starting to see it already. You see it in the size of the balance sheet – the growth this quarter in margin, the growth this quarter in whole loan products. But independent of that I would say our view has always been that this value proposition you create has lots of different components. One of them is price, one of them is functionality, one of them is service.

In a rising rate environment, we have typically, in the old days as a bank and now as a consolidated enterprise, do better because customers begin to focus on cash as a more interesting and unique product. And what you will find is people have different behavior for different parts of their cash.

You know, there is a part of the cash, which is invested at all times and there is a part of the cash that's unvested. Unvested typically fits in types of accounts like sweep or free credit. Interest rates matter. They matter less. When it is their invested cash and they are growing a bigger part of their overall allocation in cash because of the uncertainty of the market, at that point value and rate matters more and so you see more growth in things like certificates of deposit and money market accounts. But as you look across all of our products I think we have done a very good job of being
able to again, it is a rising rate environment. We did see cost of funds go up, but they went up 26 basis points against an increase on the asset side of 31 basis points. You will notice that in the guidance for the second half of the year we said spread could be anywhere I think from about 285 basis points to about 300 basis points. I believe that was the range that we gave. So we said given that we are currently at 291 or that we see opportunity going as high as 300, so you could be up another 9 basis points. But we also said there is some chance that if we want to take advantage of a tremendous opportunity in the marketplace to grow cash. And we see that in products like money markets and/or CDs as long as they are products that we are selling to our current customers.

I mean, this past quarter one of the things that we saw was the growth in all of our deposit accounts. What's the number, Jarrett? Like 75 or 80% of them were related to cross sell. So it was growing cash products by engaging with our existing customers and adding to the balances as well. So again, it is people who are interested in having that holistic relationship, an entire relationship with us as opposed to somebody who simply is just putting cash in for the rate at this moment in time.

<Q – Richard Repetto>: Okay. Great. And just if you could just tell Rob we are ready for the second half of his guidance which has a net revenue, the income and everything else that was in the previous guidance, if you remember. Thanks. That's all I have. [laughter].

<A – Mitchell Caplan>: Touché.

Operator: Your next question is coming from Mr. Matt Snowling with Friedman Billings. Please go ahead.

<Q – Matt Snowling>: Yes. Great quarter guys.


<Q – Matt Snowling>: I just want to follow up on the question on cash and you may have answered this. But given the conditions of the market I was surprised that you only had about 400 million of cash sweeping into the bank. Does that mean that the customer is actually going out and searching for higher rates with –

<A – Mitchell Caplan>: Actually what happened is, if you look at the – what you are seeing is the net result of all of the activity in the quarter so you are absolutely right. So what you would have traditionally seen was a couple of billion dollars. I think it was as high as 1.7 billion or 1.8 billion that initially went in sweep and from sweep some of it stays there and some of it moves into other areas like the transactional accounts, like money market CDs and otherwise. So it is a question. The ideas is that you saw the overall I think 1.7 billion in growth in overall deposits and you are right, a portion of it was in sweep. I think it was 400 million that was in sweep.

<Q – Matt Snowling>: Right.

<A – Mitchell Caplan>: It may have been a bigger number and then you may have seen some of it re-allocate.

<Q – Matt Snowling>: Is this really driven through the Cash Optimizer product that you have?

<A – Mitchell Caplan>: 100%.

<Q – Matt Snowling>: Okay great. And you guys mentioned some opportunities on the international front. I was wondering if you could go into a little bit more detail about particular markets or products that may be interesting at this point.
<A – Mitchell Caplan>: Well, I think there are two things we are trying to attack in tandem. The first is our core businesses in both Europe and Asia. And so we really operate out of the U.K. We passport into most of the other European countries out of a central location from our U.K. operation in London and then the second is Asia where we pretty do the same thing from our Hong Kong base. In each of those, I think we have talked in the past how we are surprised quite frankly not only were you seeing growth in daily average revenue trades. And I think Jarrett touched on that in his comments, where you saw in the quarter a 5% increase in daily average revenue trades internationally while you saw a decline on the U.S. side. And I think we are up in daily average revenue trades about 80 or 82% year-over-year and that is obviously not impacted at all by the acquisition since there are no revenue trades coming from the international locations as a result of either Harris or Brown. So that's just a pure growth there.

And independent of that we discovered that we had a billion and growing of cash. So one of the first things that we've begun to do is market U.S. dollars and denominated cash as a product in both our core European and Asian locations. You are beginning to see growth. As it gets to be a bigger and bigger number, we will start to break it out separately for you. And at the same time we believe that the right way to run the overall business, and that is what I think Jarrett was talking about in his comments, is you will see us in both Europe and Asia by way of example having a balance sheet.

And so you are not only engaging in just cash but you are engaging in cash and credit. You are putting it on a balance sheet. Each of those balance sheets in Europe and Asia will consolidate into one global balance sheet and we believe that there is interesting opportunity for growth there. I suspect you will hear more about that as we give guidance for 2007 later this year.

Similarly we are approaching sort of a different tact around the emerging markets, and we think that there are some interesting opportunities for us in our business model in places like India and China and the Middle East. It is a situation where we would do it a little differently likely with a partner, and, you know, again I think we will talk more about that as we give more specific guidance for 2007 later in the year. But it is an avenue that is interesting to us. And then on top of all of that I guess it wouldn't be shocking if the opportunity presented itself to look for consolidation or partnership opportunities, whether it is in the emerging markets or Europe or Asia.

<Q – Matt Snowling>: Great. Thanks.


Operator: Thank you. Your next question is coming from Mr. Mike Vinciguerra with Raymond James. Please go ahead.

<Q – Michael Vinciguerra>: Thanks. Good afternoon.

<A – Mitchell Caplan>: Hey, Mike.

<Q – Michael Vinciguerra>: I want to just clarify back on the cash growth question. You did a billion dollars this quarter net of the two what we think are one-time items. You're looking for 1.7 to 3.8. Am I looking at that correctly, the right comparison? That's net of any loss of money market mutual funds as we saw this quarter.

<A – Mitchell Caplan>: That's right.

<Q – Michael Vinciguerra>: Okay. Fair enough.
<A – Mitchell Caplan>: That's exactly right. So I guess on the low end it would be whatever it is, 1.7 billion, 1.8 billion for the second half of the year, 850 a quarter. On the high end at 3.8 you would see us back at 1.7 billion or something that you saw in the prior quarter.

<Q – Michael Vinciquerra>: Okay. Thank you. And two questions on the bank balance sheet, I guess. When I look at CDs balances rising so sharply in the quarter, what's the strategy there? Are those brokerage CDs, are those coming in through your own retail channels, what was the driver?

<A – Mitchell Caplan>: Yes, they are pure retail. They have nothing to do with broker. They are coming in entirely through our earn channels and Rob is showing me the number so I get it right. About 77% of the CDs as well as the other deposit products came in as a cross sell from our current customers.

<Q – Michael Vinciquerra>: Okay. Fair enough. One question I did have on the balance sheet. When I look at your interest, repurchase agreements are the second largest funding source you have, and they are also, according to the stats that you guys released, your most expensive funding source. I'm just curious why there is such a big percentage. And is there a way to reduce that, is it really that you are trying to drive the customer cash so you can then slow the utilization of repos and bring your average cost of funds down.

<A – Mitchell Caplan>: First of all, I know this frustrates you, and I understand it. And it frustrates me. But when you look at the face of the numbers it is hard to understand what is the most or least expensive cost. Because you may for example have disproportionately attached some of your hedges to your reverse repurchase agreements making them look more expensive than for example a Federal Home Loan Bank advance or borrowing. So you can't automatically assume that your reverse repurchase agreement is in fact more expensive than your FHLB.

I think as a practical matter, Mike [inaudible], who runs our Treasury group, is constantly managing what's the most effective way for us to borrow. Is it a Federal Home Loan Bank advance or is it a reverse repurchase agreement with the street. But the more important question that you asked is, can we continue to grow cash and can we continue to take down what we view as wholesale borrowing which would include reverse repurchase agreements and FHLB advances, and the answer is yes. A year ago I think it was about 50% that our deposits were bored to the percentage of our total interest bearing liabilities. Now we are at about 63%. Our stated goal is to move to 70% and then go beyond that.

<Q – Michael Vinciquerra>: Great. Thank you. And then just for modeling purposes on the tax rate around 35% the last couple of quarters, is that a good rate to use Rob going forward.

<A – Robert Simmons>: Yes, I would say it is going to be there, maybe a little bit higher. Again it depends on the mix of where the income is derived. Again we benefit a little bit as income is derived internationally and again you saw that on a relative basis international was strong in the second quarter.

<Q – Michael Vinciquerra>: Thanks very much guys.


Operator: Your next question is coming from Richard Herr with KBW. Please go ahead.


<Q – Richard Herr>: Just a follow-up on Mike's question on the tax rate. The new guidance, does that assume a 35% or does it assume a 37 as we had in the prior guidance?

<A – Robert Simmons>: We didn't specifically comment on rate but you have got the right range there. It is going to be in the 35 to 37 range.

<Q – Richard Herr>: Okay. Okay. And maybe we can get an update. I'm not sure if you guys mentioned on the consolidation on the bank and broker balance sheet. I think it either was the last call or maybe it was investor day we had spoken sometime in the summer.

<A – Mitchell Caplan>: Happy to do it. And nobody asked, and we didn't give an update. Again we said sometime during the summer. We continue to remain very comfortable with that, and I think a couple of points I can probably give you that will perhaps give some guidance in how we are looking at it.

Number one, again, we are through the process of the discussions with most, you know, all the regulators and at this point we feel very comfortable with the guidance that we gave around the summer. And then more importantly as we just upped our guidance for the rest of this year, tightened and upped our guidance. I think a part of that is we are seeing a lot of engagement from our core customer base. Again, Jarrett talked a little bit about this. We are seeing improved growth rates in the mass affluent customers, it's growing at about a 35% rate. And so you are seeing a lot of that translate through into the actual performance around revenue per customer and earnings and all of those metrics. So we felt good about that.

We felt pretty good obviously about the attrition level. We beat both of them with respect to both Harrisdirect and Brown. And included in our guidance is an assumption obviously that we are going to get clearing under the bank. Should we not for any reason, we have a plan B and that plan B gives us the economics that again makes us completely comfortable with the guidance that we have just given you. So we don't see any risk to that but imbedded in our guidance that we just gave you is the assumption that we will be fine with respect to this goal.

<Q – Richard Herr>: Okay. That's great. Thanks for the update there. One topic that hasn't come up in a bit is consolidation. Seems like everybody focusing on the summer slowdown has kind of stopped talking about it. But, Mitch, what do you see the opportunities on the horizon? Has there been any more kind of discussions since the last round last year or two years ago about people looking to pair up?

<A>: You know, I think it is fair to say that in general, it would be unrealistic for any of us to not recognize the value that has been created through consolidation. I mean clearly I suspect Ameritrade sees it in connection with some of their numbers and what they’re looking at with respect to TD Waterhouse. Clearly you are seeing the benefit for us both in the current outperformance in the first half of the year and now what we have gotten into in the last half of the year. That's a piece of it as you look at Harrisdirect and Brown. You know Schwab, anybody in the marketplace. There is no way to avoid there's a there is economic value associated with consolidation. So my guess is that when you look at both here and abroad and that, you know there will be continued consolidation in the future. I really believe and I'm not going to put a timeline on it but I do believe that the opportunity exists and I think it probably will occur.

Independent of that for us is also what are the other avenues that are interesting. What are the other pieces of our model where we believe we can turbo charge that growth and continue to deliver the kind of outpaced performance that we are delivering this year as a result of really strong core economics as well as any other smaller consolidations that we may do.

<Q – Richard Herr>: Thank you. Thanks for taking my question and congratulations on a good quarter.
<A – Mitchell Caplan>: Thank you very much. Appreciate it.

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

<Q – Prashant Bhatia>: Just quick question on the – you mentioned your – I guess done with the merger related synergies on the expense side.

<A – Mitchell Caplan>: No we are about 98%. So I think one way to be think about being fully done is Rob guided to one more penny next quarter of integrated-related, integration-related expenses or deal-related expenses. And I think one once you get through that quarter you would be done and you would have seen the full value.

<Q – Prashant Bhatia>: So when we, we take the expense base you have here the 351 million back out the merger related charges and kind of 340’ish, you have some restructuring charges in there as well, it is kind of the run rate we should assume going forward.

<A – Mitchell Caplan>: Yes. And the only thing that would obviously change that is you have obviously some variable expenses based on the overall performance of the business.

<Q – Prashant Bhatia>: Okay.

<A – Mitchell Caplan>: And then secondly, it does not presume that we continue to look for cost efficiencies in the business which I think we will always do.

<Q – Prashant Bhatia>: Okay. Great. And then in terms of growing the balance sheet I guess your guidance now shows period end assets getting to about $50 billion?

<A – Mitchell Caplan>: Yes. I actually think it may be average.

<Q – Prashant Bhatia>: Okay. You are getting the average. Okay so the period end could be even higher.

<A – Mitchell Caplan>: Yes.

<Q – Prashant Bhatia>: When you think about the deposit growth numbers that you have put out, can we, should we be assuming you get to kind of a 30% wholesale fund rate by the end of the year or is that too early or –

<A – Mitchell Caplan>: You, directionally you are correct. It may be a little less than, little more than 30, a little less than 70 but you are continuing to move in the right direction absolutely.

<Q – Prashant Bhatia>: Okay.

<A – Mitchell Caplan>: It is a great way to think about, it is how I think about the model.

<Q – Prashant Bhatia>: Okay. Great. And then just finally I think you purchased a couple of RIA firms. You have one more pending. How much success are you seeing in getting some of the E*TRADE customers to use these RIA’s.

<A – Mitchell Caplan>: Let Jarrett do it.

<A – R. Jarrett Lilien>: Well, we are seeing a lot of success and measuring it right now with a few advisor firms the percentages look unbelievably great but we are starting from small base. But it is directionally exactly what we want, It is proving out the whole model that we are looking to build out
this regional network. And what we are seeing is that we are getting leads both directions, we are getting leads both from the E*TRADE customer base that we are being able to hand over to our advisors and likewise the advisor customers that we have acquired are starting to engage and utilize E*TRADE product, you know, that we are producing. So far it is very, very encouraging but as I said still early days and still something that we are building on.

<A – Mitchell Caplan>: And the other thing I might point you to in terms of the absolute dollars is if you look at the face of the P&L and you look at some of the other revenue you can begin to see it growing. And typically in the other revenue category part of the growth is – what you will see is from the fees related to … service charge and fee line?

Okay. So in the service charge and fee line you can see the growth from quarter over quarter. And a part of that growth is due to the fees that are coming out of the advisor business. And, you know, that would be on top of the run rate that we acquired that was already imbedded in there when we acquired them in the prior quarter. So you are beginning to see more growth in fees and a lot of those fees are coming from the referrals that Jarrett is talking about that we have begun to make from our customer base in those regions to those advisors.

<Q – Prashant Bhatia>: So the RIA business, the revenues are booked as service charges and fees and we should look for that to grow as the business grows.

<A – Mitchell Caplan>: That's correct.

<Q – Prashant Bhatia>: Great. Thank you.

Operator: Okay. Your next question is coming from Mr. William Tanona with Goldman Sachs. Please go ahead.

<Q – Bill Tanona>: Good evening guys. On the net new broker banking accounts obviously they have been pretty strong in the last two quarters and you touched upon this a little bit in terms of talking about the CDs, but can you give us a sense as to what percentage of those net new accounts or new openings are coming from outside investors or new investors? What percentage is coming from previously or heritage E*TRADE and then what percentage is coming from Brown or Harris?

<A – Mitchell Caplan>: Yes, that is, that's the mix. So about 77% of them are coming from our current customer base. Okay?

About 23% are coming from outside as new customers entering into the system, on the standalone, pure banking and lending. Of the 77%, I cannot give you the expect percentages but I looked at the numbers the other day there is a disproportionate growth in these last two quarters in that both the last quarter and prior quarter coming from Harrisdirect and BrownCo customers engaging around not only their core investing account and trading but also beginning to open the bank accounts they are using for their cash management products.

<Q – Bill Tanona>: Okay. That's helpful. And then you also mentioned that you’re 98% of the way through on the expense synergy side. Can you give us a sense as to where you stand in total overall synergies for both Brown and Harris and, you know, in terms of thinking about prioritization, consolidation obviously is one but, you know, what other are your key growth areas that you are focusing on? How would you prioritize consolidation international growth versus domestic growth?

<A – Mitchell Caplan>: Okay. So first of all let me answer your question about the two deals. The synergies that we guided to were obviously both expense synergies and revenue synergies. On the revenue side they were driven by things like balance sheet consolidation both margins as a product as well as cash as a product. And then trading. And then independently on the expense synergy
side it was across the board in almost every category comp and benefit, professional services, you know, literally across every one of the categories.

We indicated that we were about 98% of the way as you just pointed out on the expense side. On the revenue side we are there and actually ahead of plan. And the reason that you know that we are ahead of plan is because we didn't assume that there would be any additional engagement when we initially gave guidance around each of these deals. We just assumed that whatever was on balance sheet from those customers around cash and credit would be moved onto our balance sheet and we would optimize it.

You have actually seen not only that get moved over and optimized; you have seen additional engagement which has driven more revenue synergies than we would have guided to at the time we did the deals. The last piece would have been around our market making operation and bringing over order flow and in this past quarter, actually one of the things that was surprisingly strong for us was our institutional business. So if you look at our numbers I think our commissions were down by about 5%. Retail commissions, which really are disproportionately the largest part of it, were down 6, but institutional was only down 1%. And when you look at principal transactions it is up because our market making business was stronger, A, as a result of some international operations that we're beginning to realize there and the value around that. As well as around the full internalization of BrownCo in this past quarter.

So I don't know if that helps you think about where we are but we believe that we are complete with integrate the conversions and the integration of Harrisdirect and BrownCo. As Jarrett said in his comments, they are a part of our company now and we just think about continuing to grow the business organically.

We think there is a lot of opportunity both domestically as we have repositioned ourselves to be more of a focused player with those customers who are building wealth at, you know, 44 million households at the U.S. alone. So we are attacking that first and foremost but we also think over the long term, meaning over the next two to five years there is a huge amount of opportunity on the international front and it is competitively in a very different place than where the U.S. is.

Most of our direct U.S. competitors have withdrawn from their international operations; we stayed firm. We have turned the business into one that's actually become quite profitable. Its op margins have improved pretty dramatically and it is something we would use to use as a very strong growth vehicle in the next two to five years.

<Q – Bill Tanona>: That's very helpful. Thanks.

And then I guess lastly in terms of opening of new offices, new centers, you know how should we think about you guys growing those going forward I guess over the next 12 months and how should we think about kind of the profitability and how long does it take for those to become profitable on average.

<A – Mitchell Caplan>: Got it. So right now, I think as we entered the quarter we were about 16 if I remember correctly. I think, 16 or 17. I though we opened up 4. We opened 3. So we went from 17 to 20. So we now have about 20. Typically it runs us anywhere from 3 to 500,000 on an annual basis to run one of these. 300 would be a branch in the cities where the square footage is a little smaller. 500,000 would a branch in a city where the square footage is a little bit larger. And what we are demanding and what we are seeing is payback in under 18 months.

<Q – Bill Tanona>: Right. Thank you.

Operator: Your next question is coming from Mr. Patrick Pinschmidt with Merrill Lynch. Please go ahead.

<Q – Patrick Pinschmidt>: Good evening guys.

<A – Mitchell Caplan>: Hey.

<Q – Patrick Pinschmidt>: Quick question on total client asset growth. Last quarter you mentioned that can Xing out the market appreciation total client assets grew 14%. And I guess can you give maybe a similar metric for this quarter Xing out the market depreciation.

<A – Mitchell Caplan>: You know what. We have been working on trying to create, what we want to add to the metrics, just a flow number because we think it is the right thing to do. And you will see it next quarter.

<Q – Patrick Pinschmidt>: Okay.

<A – Mitchell Caplan>: By next quarter you will see an absolute flow report which shows you exactly that. Part of the problem with assets and the movement in the value of the assets, I mean – Jarrett and I both are convinced that there is a huge value to our Corporate Services Group and the reason that's the case is when you look at the sheer volume of both the number of customers and the value of both the vested in the money options and the unvested in the money options, it's a hug number. We have been extremely successful in these last five quarters at growing cash from those customers and then retaining that cash and then ultimately using that as a point of entry for our customers to do other things with us across the business. So that's the good news. The bad news is, as you well know, it is a very volatile number based on what's happening in the underlying equities market.

So in this particular quarter, you know, 15% of our overall assets are coming from the vested and unexercised options, and those were down 17% in value. So it sort of disproportionately drops the overall value of where we are, or can do the same thing to the upside on the asset. So we sort of look at it just as a feeder and an opportunity out there but we recognize what we really need is to get this report to everybody publicly and you will see it next quarter.

<Q – Patrick Pinschmidt>: Great. In terms of employee headcount, full-time employees were up 8% during the quarter. Does this relate primarily to the compensation expense investments you have been making.

<A – Mitchell Caplan>: Yes it is almost exclusively related to service. My recollection is if you look year to year we were up 12 or 1300. Literally like 11 something of that was entirely related to service. And then exactly the same thing would be true on a quarter to quarter trend.

<Q – Patrick Pinschmidt>: Okay. And then final question on commission rate guidance I know this is really small but you took down the commission rate guidance.

<A – Mitchell Caplan>: Nothing to do with pricing and everything to do with mix.

<A – Mitchell Caplan>: Gotcha.

<A – Mitchell Caplan>: We are extremely comfortable where we are currently pricing.

<Q – Patrick Pinschmidt>: Okay. Thank you.
Operator: Okay your next question is coming from Campbell Chaney with Sanders Morris Harris. Please go ahead.

<Q – Campbell Chaney>: Hey everybody. I'm looking at your schedule for average enterprise balance sheet data. I'm looking at the yield on the margin receivables. They went up about 52 basis points for the quarter. Can you give us an idea of what your interest-rate outlook is for the remainder of the year and how influential this number is going to be for your margin outlook.

<A – R. Jarrett Lilien>: Yes. So let me step back and do it a little more broadly if I can because rather than thinking. I know some of our competitors talk specifically about margin and what happens in a fed hike with respect to their margin balances. But we believe that the right way for us to manage our business is to run a consolidated balance sheet and then look at total assets and total liabilities – margin being a part of the overall asset pool or the asset mix.

And one of the things that we have tried to do consistently I guess over these last 17 years, and we talked a little bit about it on the call, is obviously be conservative with respect to the credit and the same is true with respect to interest rate risk. So by and large our position has always been modeled to a flat yield curve and put ourselves in a position where we are relatively neutral with respect to interest rate risk. So that there is no way you are absolutely neutral but if you think about our business it is an interesting statistic. If you thought about the bank balance sheet standalone like many bank sheets you would be liability sensitive. When you consolidate and run an enterprise balance sheet we suddenly become asset sensitive. So clearly what that means is in a rising rate environment it will help us. And you are basically pretty neutral. Your duration mismatch at this point is about three months. I suspect what you would see is up 100, you might see an increase of about $40 million in earnings and up 50, you might see an increase of about half that. That's sort of the range that you might be willing to think about.

<Q – Campbell Chaney>: Great. Got it. I'm sorry, you said your duration mismatch is three months.

<A – Mitchell Caplan>: Three. Three, four months.

<Q – Campbell Chaney>: And you manage it into that range?

<A – Mitchell Caplan>: Yes we do.

<Q – Campbell Chaney>: Okay.

<A – Mitchell Caplan>: I mean typically it is the range that I'm pretty comfortable with, Jarrett is pretty comfortable with. Dennis is sitting here, that he is comfortable with. We have often found ourselves in under two months but typically that was because you were in a situation where interest rate perspective, interest rates were still flat to down, prepayments came in higher, your overall balance sheet was smaller than you thought it would be. Now in a rising rate environment you're not as susceptible to prepayments and it is a little easier to manage where we are and we are coming in just about that three, four month rate for that mismatch that we feel comfortable with.

<Q – Campbell Chaney>: Looking at your average whole loans quarter to quarter, did that come from your loan Optimizer or how did you get that growth.

<A – Mitchell Caplan>: Yes. So we are able to continue to grow our loan portfolio both on mortgages, home equity lines of credit and margin. I mean you saw margin growth. I think margin was up 500 million quarter over quarter on balance sheet. And about 4, 500 million as well in our whole loans and a lot of this is really as we begin to engage more and more with our customers.

<Q – Campbell Chaney>: Safe to say this was all organic from your existing customers?
Some of it is organic, some of it is purchased, but we have made a huge transformation away from being in the traditional sort of mortgage business where you originate and sell or whether you are purchasing or whatever. And really pushed hard toward the growth of our balance sheet coming from our core retail customer.

Thank you.

Operator: Your final question is coming from Mr. Michael Hecht with Banc of America Securities. Please go ahead.

Hey guys, good afternoon.

Hey, Michael.

Pretty much gone through everything now but just a couple of quick follow-ups. You guys talked about the economic attrition 10% at Harris 5% at BrownCo. I'm curious about account attrition that you are seeing as it relates to Brown specifically. I know the conversion is mostly behind you. I'm just curious, have you converted their pricing schedule to your own or are those accounts still grandfathered at the 5 and $10 per trade.

They are grandfathered, but it doesn't matter because they look from a behavior perspective much like our active customer who are effectively paying the same rate.

And the account attrition.

Account attrition we didn't give it but it is not meaningfully different.

Well where you’ve got account attrition is the account attrition is slightly more than the economic attrition and what that is telling you is the accounts that we are losing are less than the average quality customer. So we are keeping the high quality, the active traders, the high asset customers, the ones we are losing tend to be the lower activity, lower asset customers.

Right. Okay. That's fair.

I just wanted to come back to this question on the balance sheet of the decline in cash in the quarter. The 11.5 that went to 10.1, because when I look at your overall balance sheet your free credits only fell 300 million which are probably the lowest yielding form of balance for a retail customer. Which implies that you had over $1 billion decline in money fund balances, which are the most competitive.

And they got moved onto the bank's balance sheet.

Okay.

You are looking at two different things. You have to look at it in the aggregate. The overall deposit growth on the balance sheet was 1 billion 7. So you had 1 billion 7 in growth in customer deposits in the quarter that was comprised of CDs, money market, other forms of transactional accounts and sweep. And then independently you had the cash balances or free credits which were outside of that and that's where you saw the decline.

Okay. And that's kind of – the money fund side some of the stuff you talked about the attrition from Harris some of the tax selling.

That's right exactly what it was.
<Q – Michael Hecht>: Okay. And I'm guessing you guys don't want to comment on trends you are seeing for July DARTs. But most of your competitors are saying they are only down slightly is it fair to say you guys are tracking the industry there?

<A – Mitchell Caplan>: We are always going to track the industry, as Jarrett likes to say, plus or minus. I refuse to comment about something that's so insignificant to our overall business model over the last however many days.

<Q – Michael Hecht>: I agree. I'm just wondering if you can maybe comment on whether the activity your are seeing out there broadly on the retail trading side, while maybe insignificant is still maybe substantial to you.

<A – Mitchell Caplan>: Not substantial anymore. It is about 20% of revenue.

<A – R. Jarrett Lilien>: Another way to look at it is if you look at our guidance we have said for the second half of the year we expect a range between 140 and 160. In the first half of the year we were at 173. So we are expecting and we have built in to our up guidance lower activity in the second half.

<Q – Michael Hecht>: Okay. And I mean just kind of broadly the activity that you are seeing out there on the trading side do you think it is more typical seasonality or are you seeing evidence of retail folks just heading for the hills? How are you feeling about the environment?

<A – Mitchell Caplan>: It is normal seasonality.


<Q – Michael Hecht>: OK. Great. Thanks, guys.

Operator: I would like to turn the floor back to Mr. Caplan for his closing remarks. Please go ahead, sir.

Mitchell H. Caplan, Chief Executive Officer

Thanks very much everybody for joining us, and we will speak to you on the earnings call for Q3.

Operator: Thank you. This does conclude today's E*TRADE conference call. You may disconnect your lines at this time and have a wonderful evening.