MANAGEMENT DISCUSSION SECTION

Operator: Welcome to E*TRADE FINANCIAL Corporation's Second Quarter 2007 Earnings Conference Call. At this time, all participants have been placed in a listen-only mode. Following the presentation, the floor will be opened for questions. I have been asked to begin this call with the following Safe Harbor Statement.

During this conference call, the Company will be sharing with you certain projections or other forward-looking statements regarding future events or its future performance. E*TRADE FINANCIAL cautions you that certain factors, including risks and uncertainties referred to in the 10-Ks, 10-Qs and other reports it periodically files with the Securities and Exchange Commission, can 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 25, 2007. Please note that E*TRADE FINANCIAL disclaims any duty to update any forward-looking statements made in the presentation.

In 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 www.etrade.com.

This call is being recorded. Replays of this call will be available via phone, webcast and podcast beginning at approximately 7 o'clock p.m. Eastern Time today through 11 o'clock p.m. Eastern Time on Wednesday, August 8. 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'll 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

Good afternoon, and thank you for joining us for our second quarter conference call. A year ago this quarter, we had just successfully completed two back-to-back acquisition-related conversions. We integrated three companies into one, while remaining focused on broadening and enhancing our value proposition across our entire customer base. At that time, we laid out a strategy for organic growth. At the core of that strategic plan were increased investments in marketing, service and technology, to heighten product awareness and engagement, improve customer experience and boost operational efficiency. Over the past 12 months, we have made these investments and our record financial performance and reinvigorated customer growth trends are proof points of success.

For the second quarter, we earned $0.42 per share, up from $0.39 in the prior quarter, on record revenue of $664 million. The $0.42 excludes a $0.05 charge for one-time legal and regulatory items. Therefore, on a GAAP basis we earned $0.37 per share. The charge relates almost exclusively to a reserve we have set for an SEC inquiry of exchanges pertaining to certain institutional market making activity, which was previously disclosed in our 10-Q and 10-K filings. The majority of this activity took place between 1999 and 2001. We are working closely with the SEC and hope to reach a prompt resolution.

Excluding the impact of this charge, the business delivered record segment income of $296 million. Pro forma operating margin also reached a record, up 300 basis points quarter-over-quarter, to 45%. While we are, of course, pleased to deliver these record results, we are even more pleased to also deliver an increased overall quality of earnings. We achieved record revenue, even as we reduced loan and security gains and increased our provision for loan losses. The revenue in the quarter was driven by increases in net operating interest income, commissions and fee revenue, all items directly related to the growth and engagement of our core retail investing customers.

Our second quarter performance speaks to the progress we have made as a company in executing against our strategic plan. We set out to drive results through investment and we are achieving them. The aim of our investment strategy is to drive organic account growth, and particularly growth within our target segment.

In the second quarter, we opened 324,000 new accounts, including 199,000 new trading and investing accounts, the strongest in at least five years. We also increased our base of target segment accounts at a 29% annualized rate, or by 66,000. These accounts represent tremendous current and future economic value to the business due to their attractive demographic and product engagement trends. They are valuable to our model as the customers behind these accounts show four times the level of engagement around assets, trading, margin and cash, relative to our average customer.

Our model generates exceptional value from these relationships, as we are able to leverage growth in assets and activity across our integrated technology, operations and service platforms, driving results in both our retail and institutional segments. We are also pleased that these positive engagement trends we have seen this year are continuing into the current quarter. Assets, cash, margin and DART [Daily Average Revenue Trade] are all up nicely so far in July, and our pipeline of new unsegmented accounts remain strong.

By expanding our base of these high-quality accounts, we delivered another quarter of strong growth in total client assets, which increased 6% quarter-over-quarter and 18% from a year ago to a record $213 billion. Asset balances increased in all categories with the exception of CDs, which continue to slowly decline as part of our re-pricing strategy. The cash component of our client assets grew by 1.9 billion, to $37.9 billion. Solid result, particularly considering the seasonal tax related outflows in the second quarter. This time last year cash balances increased by just 300 million. So the $1.9 billion growth this quarter represents another example of the returns we are realizing on our marketing and value proposition investment.

Also, as a result of our broad sweep of investing in cash management products, we continued to successfully accumulate cash and deposit balances for balance sheet growth at an attractive blended cost of funds. In the quarter, our growth in retail cash balances came in at an incremental cost of 3.68%. In addition, and most importantly, this growth is being fueled by broadening engagement from our new and existing customers, and primarily investing base customers who accounted for 81% of the new deposit account balances in the quarter.

On the asset side of the balance sheet average interest earning assets grew $4.8 billion quarter-over-quarter to approximately $58 billion. Whole loans accounted for 3 billion of the growth and more than 100% of the growth in whole loans within 1-4 Family prime and super prime first lien mortgages. HELOC [Home Equity Line of Credit] and consumer loan balances declined during the quarter, ending lower as a percent of total loans and in absolute dollars.

As we manage through the credit environment, we have been able to opportunistically improve loan quality in the portfolio with growth in super prime first lien mortgages while maintaining yield, partly the results of a somewhat improved yield curve. We expect to continue this mix shift towards first lien mortgages for the remainder of this year. We also maintain our strict discipline with respect to risk mitigation all the way down to the level of the borrower. To that end, average FICO, DTI and CLTV metrics across the portfolio all remained unchanged quarter-over-quarter at a solid 735, 35 and 73% respectively.

While we remain vigilant with respect to our credit risk management, in no way do we assume that we will be immune should trends worsen from a macro perspective. We do, however, expect to be less affected on a relative basis given the relative quality and mix of our assets. With respect to our specific credit metrics in the quarter, net charge-offs increased slightly, up $1.5 million from 20.8 million in the first quarter. Net charge-offs as a percent of average loan receivables declined by 1 basis point quarter-over-quarter to 29 basis points.

Non-performing loans increased by $50 million and we increased our quarterly provision by 9 million to $30 million. Provision exceeded charge-offs by nearly $8 million in the quarter, increasing allowance for loan losses to approximately $76 million. In addition, the percent of non-performing loans that charged off in the quarter declined to 19% from 28% in the prior quarter and 26% in the fourth quarter. We believe that given the relatively higher FICO scores and lower DTI levels of the borrowers in our portfolio, these individuals are more likely to be refinanced and avoid foreclosure.

Finally, there has been a lot of discussion in the industry recently regarding consolidation. While our focus and first priority continues to be the tremendous global growth opportunity that lies ahead of us, we are always looking for opportunities that can either accelerate current growth initiatives or deliver greater scale sooner. As we have demonstrated in the past, we believe in the strategic and economic benefits of consolidation and will evaluate any transaction that we believe generates superior long-term value to shareholders.

Now to provide further details on the operational success of the quarter, I would like to turn the call over to Jarrett.

R. Jarrett Lilien, President and Chief Operating Officer

Thanks, Mitch. We are pleased with the performance of the company this quarter. It demonstrates that our focus and efforts are moving the needle. More importantly the returns we are now seeing validate the investments we've made over the past five years to strengthen and transform the franchise. We invested in products, service and functionality to enhance customer experience and to continue to be a leader of innovation in the industry.

SmartMoney Magazine's annual broker survey rated us Number 1 among premium brokers for the first time ever. The difference this year, significantly improved customer experience. While we have seen the tremendous progress we made ourselves, we are excited to have received this external validation from SmartMoney. Our internal measurements of customer satisfaction are at a record high and have increased in 10 of the 12 past months. These improved customer experience and satisfaction levels are now translating into solid growth across our core customer metrics.

Mitch already spoke about the success of our account growth and particularly the value of growth in our target segment, but our success is much broader than that. We are also seeing strong growth in our Main Street account base, which grew at a 9% analyzed rate in the quarter. Our investment in service and product is also driving success this year in migrating a greater number of our Main Street customers into the target segment where they create the highest value. We've leveraged our marketing spend with personal contacts through our call centers and branches to increase product awareness and utilization. Year-to-date we have successfully migrated 30,000 Main Street accounts into our target segment, well ahead of our internal expectations for the full year.

Not only are we experiencing growth at the account level, but also at the customer level. In the quarter, we added just over 51,000 net new customers, the strongest growth in customers in over three years. As a result, we are growing customers and are in engagement with them, and this is driving strong activity margin and cash growth. Total DART volumes held steady in the quarter, declining by just 0.5% from the seasonally strong first quarter level, and increasing 2% from a year ago. That year-over-year growth is even better than it looks, considering that we had integrated two companies and we're just entering the peak attrition period. Average commission for trade rose

$0.14 quarter-over-quarter to $12.03. Interestingly, this increase was the result of product mix rather than customer segment or geographic mix.

Options volume remained strong in the quarter and represented 15.4% of US DART volume, up from 14.1% in the first quarter and 12.4% a year ago. In June, our option DART volume hit a record 16.3% of US DART volume and increased 49% year-over-year. What's perhaps most encouraging about this growth in options volume is that it's being driven by customers who are using options to hedge rather than speculate, and by a growing portion of our account base.

Two years ago we made investments in our options platform and value proposition, and these results are just another example of the returns we are now realizing from that investment. Margin debt and customer cash also increased nicely quarter-over-quarter, driven again by the growth in our target segment accounts. Margin debt ended the quarter up 7%, at $7.5 billion.

On the cash side, customers increased cash product balances by $1.9 billion. The outpaced growth in assets and cash balances relative to margin debt shows that our customers continue to maintain a prudent level of leverage relative to assets.

We are also generating returns on the investments we have made in our relationship manager strategy. We now have just over 300 relationship managers, up from approximately 100 two years ago. These RMs are now assigned to 70% of our customers with $250,000 or more in assets with us. Over time our plan is to expand our RM group to reach 100% coverage of these customers and then scale that service across an even larger subset of our customer base.

The ongoing return on our investment in RMs comes from growth in product engagement, assets per customer and share of wallet over time, and they are delivering results. In the second quarter, assets from customers connected to an RM increased by $1.7 billion. In addition, we are beginning to see real growth in client referrals from RMs to our wealth managers and lending specialists. Although it's still small, year-to-date referrals and closes through June exceeded the entire results for 2006.

While the customer metrics certainly tell a good story with respect to our investment returns, the true test is the economic results produced by these metrics. We are succeeding here as well. Annualized consolidated revenue per customer in the second quarter totaled $752, up from $742 in the first quarter and $716 a year ago.

In addition, this revenue is growing with increased profitability given the scale and leverage in our model. Adjusting all periods for one-time items, annualized segment income per customer grew to $336, up from $311 in the first quarter and $305 a year ago.

In conclusion, we are pleased with the success we are achieving and the impact solid organic growth is having on the model, both from bringing in new customers plus driving higher engagement with existing customers. Our investments in service and product continue to transform the business and position the business to capitalize on the positive secular growth trends in the industry.

With that, I'll turn the call over to Rob for more details on financials of the quarter.

Robert J. Simmons, Chief Financial Officer

Okay. Thanks, Jarrett. Now, our second quarter results demonstrate the strategic and economic success we have achieved through the investments we've made over the past several years. We delivered record results while also improving the overall quality of revenue and earnings, a result of this success we have shown in growing our Mass Affluent customer base. Year-over-year total net revenue grew 9%, segment income grew 14% and operating margin improved by nearly 200 basis points. These comparisons exclude the one-time legal and regulatory items already discussed. Needless to say, we are very pleased with the continued strength in operating leverage of the business.

Now, I'd like to turn to the specifics of the second quarter. Quarter-over-quarter, total net revenue grew 3% to a record $664 million. Within this increase, we also experienced an improvement in the overall quality mix of revenue with the net interest income, commissions and fee based revenue all up, and a lower contribution from gain of sale of loans and securities. Net interest income after provision expense is up 4%. Loan loss provision for the quarter was $30 million, up $9 million quarter-over-quarter, consistent with our view of the evolving credit environment.

Net interest spread showed improved stability in the quarter, declining just 3 basis points to 271 basis points squarely within our expected range for the year. Commissions grew 7% quarter-over-quarter driven by steady retail guard activity improved average commission rate and stronger trading activity in our global institutional equity business. Fee-based revenue increased 10% quarter-over-quarter on higher asset management in mutual funds fees.

Gain on sale of loans and securities contributed just 5 million, or less than 1% of revenue in the second quarter, down from $17 million, or 3% of revenue in the first quarter. The decline in gain related revenues stemmed from lower gains from the sale of originated loans. As part of our strategic decision to portfolio more of our high quality origination volume and reduce the amount sold for gains. So, overall, we were pleased with the top line results in the quarter, particularly given the improved quality and growth for more recurring customer driven components.

Turning now to expenses. We continue to realize operational efficiencies throughout the business and maintain strong expense control. Total expenses, excluding the one-time legal items, declined 2% quarter-over-quarter to $367 million. Compensation expense declined approximately $5 million quarter-over-quarter to $119 million, or 18% of revenue. This decline was due to lower payroll related taxes and reduced head count.

We have been successful in maintaining a low compensation to revenue ratio, even as we have made investment this past year in bolstering our service quality and broadening our network of relationship managers, advisors and select branch locations. Revenue per head count and revenue per compensation dollar continued to increase, further demonstrating the scale and value we're achieving throughout the business. Clearing and servicing expense rose 10% to $74 million. This increase was driven primarily by higher institutional trading volume and an increase in servicing costs consistent with the growth in our average loan balances.

With respect to advertising, total ad spend declined approximately $10 million quarter-over-quarter, consistent with our marketing plan for 2007. You'll recall that we plan to frontload the marketing spend in Q1 to drive growth in our target segment accounts early in the year and this is exactly what happened. As Jarrett discussed earlier, we experienced the strongest organic growth ever in target accounts this quarter, the result of marketing investment made in Q1.

Despite the marketing spend being down quarter-over-quarter, we still spent roughly $6 million more than last year at this time, consistent with our continued investment plans. Operating expenses, such as communications and occupancy and equipment, declined slightly quarter-over-quarter, a result of continued efficiency realization and prudent expense control throughout the business. We also had a $1.5 million credit to restructuring another exit charges this quarter, which is simply a favorable true-up to sublease assumptions built into our earlier restructuring of facilities in California.

Other expense increased by about $38 million quarter-over-quarter, but increased just $3 million adjusting for the legal items. This $3 million increase was predominately related to higher FDIC insurance premiums as a result of our growing base of customers deposits. Our reported tax rate for the quarter came in at 34%, hitting the low end of our forecasted range. For the remainder of the year, we expect the tax rate to remain closer to the low end of our 34 to 37% guidance range, partially as a result of the continued strong contributions from our international operations.

Turning now to liquidity, the business continues to generate strong cash flow, providing significant opportunities to reinvest in the business, as well as repurchase stock to create further shareholder value. In the second quarter, we did both. We made investments in marketing, service and technology to continue to drive growth and efficiency, we redeployed approximately $100 million in additional regulatory capital and used $73 million to repurchase 3.1 million shares of stock. Since our buyback activity began in Q2 of 2001, we have used $764 million to repurchase over 80 million shares at an average price of $9.50, generating close to $900 million in value. As of June 30, we have $211 million available for further share repurchase under our current Board authorization.

With respect to our 2007 guidance, we've narrowed our range by $0.06 by increasing the low end by $0.03 and reducing the high end by $0.03. Our new range is $1.58 to $1.72 per share, leaving the midpoint unchanged at $1.65. As a result of the strong customer growth and engagement trends we continue to see, we are comfortable maintaining the midpoint of our range, even as we expect to provision at or above current levels in the third and fourth quarters. For consistency purposes, this range is based on pro forma earnings that exclude the $0.05 of legal items from this quarter. In addition, we have now realized the full $0.05 in below the line investment gains that we expected for the year through the sale of E*TRADE Australia and E*TRADE Korea. As a result, there are no additional below the line gains embedded in our new guidance range for the back half of the year.

The record results generated in the second quarter represent the return on investments made over the past several years. Through these investments we are positioned to leverage our account growth, particularly the growth we are seeing within our target segments. We can do so cost-effectively to generate strong financial performance and increased value to shareholders.

And with that, we'd like to open the call to questions.

QUESTION AND ANSWER SECTION

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

<**Q – Richard Repetto**>: Good afternoon, guys. Congrats on an excellent quarter.

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

<**Q – Richard Repetto**>: I guess the target segment growth is pretty interesting. You brought on 66,000, and Rob went through that marketing spend went down. But you even brought on more, 43 in the first quarter. I guess my question is, Mitch, that number – you said about 30,000 came from existing accounts through the pipeline, so that would say less than 30% are migration, and the rest are brand new people bringing them in. Are my numbers correct, I guess is the question?

<**A – Mitchell Caplan**>: Yes. As long as you recognize that the 30,000 is for the first two quarters, right, for the first half of the year. So, that shows you, of the total that we've brought in – 66,000 in this quarter plus what we brought in in the first quarter in target segments – if you add those two, about 30,000 or so came from migration and the rest were coming from new accounts for marketing spend. So it's a great way to think about it, Rich.

<**Q – Richard Repetto**>: Okay. So, this 110 in the first half you brought through, so would you...

<**A – Mitchell Caplan**>: That's right. That's right. So, of the 110, about 30,000 or 32,000 or whatever came from migration, which is a little bit ahead of what we had originally planned when we built the budget, and the rest came from just the marketing dollars and new account growth of the right kind of customers. And again, one of the things I was also saying is, and I think you know this, we always, as we add customers in a quarter, we put them into that unsegmented bucket for the next quarter; and we're again going into this quarter, into Q3, with a very strong bucket of unsegmented, which we would hope would continue to fall out into the target segment the way we've seen and would expect the way we've seen in Q1 and Q2.

<**Q – Richard Repetto**>: So, I guess the follow-up question, then, is if 70% or more are coming right out off the street, are they still – you mentioned in the prepared remarks that they are 4x on more or less asset metrics. What about – are they still the – I think you mentioned 10x before on the revenue generation?

<**A – Mitchell Caplan**>: Yes, absolutely. So, when you look at them, the percentage of target segment customers that we have still represent about 75% of our revenue on an annualized basis. So, yes, you are right. And they are much stronger with respect to all the other metrics in terms of assets, cash, all the stuff we talked about, and then you see it flow through in terms of the actual revenue line items and you also can see it when you look at – as Rob was saying and Jarrett was saying, when you look at revenue per customer or revenue per account, profit per account, they are all up significantly quarter-over-quarter and year-over-year, and that's across all the accounts. It's – obviously a lot of that is led by what's happening in the target segment growth.

So, again, I think I was saying that – in the prepared remarks that, in July, we're very, very pleased with what we have seen so far. We're really almost through the month, the first month of the quarter. And in terms of what we've seen, our customers have absolutely been net buyers in the quarter – so far in the month. And even notwithstanding the strong net buys that we're seeing, we're seeing very strong growth in cash, continued growth in margin, and growth in daily average revenue trades that are strong – that seem stronger than what we've seen from the industry at large.

<Q – Richard Repetto>: Okay. I guess – I don't want to – my one last question, I've got to get one in on consolidation here. So, there's been a lot of activity spurred on by the buy side in some cases. But I guess the question is, as you look out on the landscape, what are your priorities? What best fits with E*TRADE, I guess, as you look at the M&A landscape?

<A – Mitchell Caplan>: Well, first of all, our first priority is -- I think as I was saying is, we have got to continue to keep our head down and focused on execution. I think it's the first time in a while as we've gone into this year that we've really seen a reinvigoration of account growth, and where we've seen the economics coming through in terms of top line revenue, controlled expenses and bottom line income. So, we are going to stay focused on that.

That being said, when you think about where the opportunities are for organic growth domestically and internationally, Jarrett is working on it and he's got it covered. Part of my job is to look at the broader industry and recognize that we've been proponents in the past of consolidation. We recognize that, with the right strategy and the right discipline and execution, you can create value. We have certainly done it over the years with a number of the acquisitions, culminating with Harris and Brown, and to the extent that the opportunity presents itself, it is something that we would take advantage of, whether it's directly in our space, which is certainly the opportunity you're talking about, given all of the discussions in the marketplace, or even in the broader financial services marketplace.

<Q – Richard Repetto>: Okay. That's helpful, Mitch. Congrats on a good quarter.

<A – Mitchell Caplan>: Thanks a lot.

Operator: Thank you. Your next question is coming from Matt Snowling of Friedman, Billings, Ramsey. Please go ahead.

<Q – Matt Snowling>: Hi, guys.

<A – Mitchell Caplan>: Hey, Matt.

<Q – Matt Snowling>: Given the recent events, Mitch, can you give us a little bit more detail on what your HELOC portfolio looks like, in terms of maybe size, delinquencies, and how much may be in the 2006 vintage?

<A – Mitchell Caplan>: Yes, virtually nothing from the 2006 vintage, which is good news. When you look at the size, it's down. It's down, and you can see it – we'll give you the specific – I can't remember the specific numbers. I know that it's down to about 4 billion. What is it?

<A – Robert Simmons>: About 400 million.

<A – Mitchell Caplan>: Yeah, about 400 million. So, in other words, what happened is we allowed all the prepayments to just move through. And again, as we said, literally – I think when we were giving guidance back in December, one of the things that we said was that we would expect to see maybe a 60 or a 65% mix of first liens and about 30% or 35%, 40% coming from HELOCs. Then as we saw and moved through Q1, we said, no, I think we're going to move more in the direction of about 75, 80, 85% of the growth coming in first liens, both in Q1 and in Q2; and, in fact, we've been closer to 100%. So, that's basically where we are. If you look at the size of the portfolio in HELOCs, it's about 12 billion or so. It's down about 400 million quarter-over-quarter. When you look at – across av, median – across, really, the average, median, mode, all that stuff, what you see are, again, the same consistent high FICO scores: 730, 740, something like that. You see DTIs and LTVs that, again, are conservative and are probably significantly better than what you've seen in maybe the general thrift industry at large or in others.

And so, my recognition is, I think our LTVs are in the mid to high 70s. So, again, because of that, what we're seeing, one of the reasons, I think, that notwithstanding we saw a reasonable increase in non-performings from Q4 into Q1, what you saw read out in actual charge-offs this quarter was down, was down from the 26% to 19%, because we're seeing that a lot of these are getting refinanced out, and we're getting pay downs on them, and that's fine. And so we're not seeing them read all the way through into charge-offs.

<Q – Matt Snowling>: What do the delinquencies look like?

<A – Mitchell Caplan>: Delinquencies are – let me get you these when we do the follow-up call, I'm going to give you that number. But I think it's about, certainly 1.5% or 2%, sort of in that range. I think probably, definitely below what you're seeing in the industry.

<Q – Matt Snowling>: Okay. One quick question on the A – the AOCI, I'm sorry.

<A – Mitchell Caplan>: Yeah.

<Q – Matt Snowling>: Looked like that dropped $130 million. I'm just wondering what may be behind that.

<A – Robert Simmons>: Sure, Matt. This is Rob. The movement in AOCI quarter-to-quarter was purely or primarily a function of the securities portfolio being marked to market, a reflection of the rate movement in the quarter and the mark on the securities portfolio. There is some offset from hedges and some offset on FX. But that's the predominant mover there.

<Q – Matt Snowling>: Rob, is this the portfolio you intend to hold to maturity, or is this for trading?

<A – Robert Simmons>: Look at this – we've talked a lot about our longer-term objectives being to be toward a more retail-oriented balance sheet, so that will definitely continue to be the trend at this point. If you look at, in the quarter – if you look at the asset mix, we had about 67% of our interest-earning assets in the form of whole loans and roughly 33 in the form of securities. So, we would expect that mix to continue to shift toward a retail mix and away from a wholesale mix.

<Q – Matt Snowling>: Okay.

<A – Mitchell Caplan>: And the other thing that I just want to follow-up with you is on the NPL, I looked it up. For the home equity, as of this quarter, I think we're in, like 95, 96 million, 98 million, something like that, in NPLs; and again, we're experiencing sub 2%.

<Q – Matt Snowling>: Great, thanks.

Operator: Thank you. Your next question is coming from William Tanona of Goldman Sachs. Please go ahead.

<Q – Bill Tanona>: Hey, good afternoon, guys. The net new assets is obviously down on a sequential basis; just how much of that was due to tax disbursements in April?

<A – Mitchell Caplan>: You got it. So, if you looked at it on a monthly basis, I think last – we were at – basically, the months of April, May and June, May and June were as strong or stronger than we had seen in the prior quarter. And April was basically flat to slightly down as a result of the outflows that you saw from tax payments. So, it's what resulted in the decline in quarter-over-quarter in the net asset inflows. Same thing happened – it's really actually pretty interesting. When you look at cash for the quarter, as we came into the last – Rob, what was it? – the last 12 days or something, or 14 days of the quarter, part of the way that we obviously grow our balance sheet on the asset side is we're now trying to match it to the growth of retail customer cash. And what you will see is that, notwithstanding that we grew the asset side of the balance sheet by whatever it was, 4 or 4.5 billion, on average, the ending point was a little over 3 billion. Because we actually moved out of securities as we finished up the quarter, and our actual growth in securities quarter-over-quarter was only about 400 million and was really driven, if I remember correctly, by both our munis on a tax advantage basis and our FHLB stock. So, when you look at where we were in cash, literally, with 10 or 12 days to go to the end of the quarter, we were at $2.7 billion. And we ended at 1.9, because we saw our customers be net buyers of in excess of $1 billion in, literally, the last 10 days of the second quarter. And obviously, as I said earlier, that has continued in Q3 to the tune of another 3 or 400 million.

<Q – Bill Tanona>: Great, that's helpful. And then, I guess, on the non-performing loans again, can you kind of help us understand exactly where you're seeing those non-performing loans pick up there, in terms of whether it's demographic or what type of loans or what geographies and segments, such that we understand it a little bit better?

<A – Mitchell Caplan>: Yes. We are basically – we continue to see low charge-offs in our first liens, basically a basis point what we have totally traditionally seen. The consumer loans are showing charge-offs that are pretty much equal to what they have traditionally shown. It's just you're seeing – obviously, you're coming down the back end of it, so you're – and you're not replacing any of the consumer loans. So, to the extent that we are seeing charge-offs, which were, as I said, only up about 1.5 million, the incremental delta is going to be coming through in the form of the HELOCs. And when we look at it, we're not seeing it in terms of any specific geography. And again, as I said, it's sub 2% in terms of what we're seeing, and with total NPLs now in the HELOC portfolio of the 98 million.

<Q – Bill Tanona>: So, there's no kind of specifics between geographies or adjustable rates or anything like that? You're just seeing kind of a broad deterioration, if you will.

<A – Mitchell Caplan>: Yes. And I'm not even sure I would even call it a significant deterioration. I mean, I think that what we saw was the pick up between Q4 and Q1, which we talked to. In Q1 to Q2, we're actually seeing less deterioration in the sense that although your NPLs are growing. We saw a definite decrease in the read through. So if you look at the NPLs in Q4 as the pipeline for Q1, we saw again about 26% of those read through. In Q2 what we saw was about 19% read through. So we actually saw a bit of an improvement, which we were pleased about. And as we've been working with the subservicers, what we're hearing is, because of the underlying credit characteristics, whether it's FICO or DTI or LTV of the borrower, they're being taken out in the marketplace by other lenders.

<Q – Bill Tanona>: Okay, thanks.

<A – Mitchell Caplan>: Absolutely.

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

<Q – Prashant Bhatia>: Hi.

<A – Mitchell Caplan>: Hi, Prashant.

<Q – Prashant Bhatia>: Just on the mortgage portfolio, I think roughly 32 billion, can you tell us how much of that you originated versus how much you bought from third parties?

<A – Mitchell Caplan>: The answer is, I don't even think I can break it out. We have originated – I think last quarter we had said a relatively small part, most of it has been bought in the industry. I think some of our big providers are Nat City and others. But we have been originating more than –

each quarter than we have in the prior quarter, I guess, for the past maybe – four or five quarters, Rob?

<A – Robert Simmons>: Five, six quarters.

<A – Mitchell Caplan>: And we are continuing to keep more on balance sheet. So we're in a place where I think this past quarter we probably originated about, what, 100 billion?

<A – Robert Simmons>: Yes.

<A – Mitchell Caplan>: A little bit more?

<A – Robert Simmons>: We kept the highest percentage on balance sheet this quarter than we have in a long time.

<A – Mitchell Caplan>: Yes.

<Q – Prashant Bhatia>: Okay. So most of the 32 is through third parties it sounds like.

<A – Mitchell Caplan>: Yes, absolutely.

<Q – Prashant Bhatia>: Okay. Now a lot of talk in the industry, some of the firms are saying looking at FICOs, looking at LTVs and so on, based on past experience really isn't proving all that relevant right now. I don't know if you're seeing that as well. But how do you get comfortable being that you didn't originate these loans with the real quality of them? And how do you know that you won't have to see charge-offs and provisionings rise going forward.

<A – Mitchell Caplan>: Well, let me address that, if I can, in two separate answers, okay? The first is that by and large when we buy, we often buy with anywhere from six to 12 months of seasoning. So we rarely buy new origination. We're buying stuff that we had seen with some seasoning issues, so we can see how the borrowers are performing. We also buy with a look-forward put-back for another six to 12 months, so that if we see some thing that we're uncomfortable with, we put the loan back. And given that historically I think when you look at how we have performed compared to the industry, we have been significantly better.

So one of the things that we talked about that we obviously hoped to see when we did see the increase in charge-offs and we increased our provisions in Q1 of this year, was we were waiting for the report that would come out on the industry, and we did maintain our relative out-performance. So if you looked at what our charge-offs were, they are typically 20 – somewhere around 40 to 45% better than the industry, usually 20 to 30 basis points better, and we saw exactly that same relationship maintained in Q1. And I think that particularly given what we've seen in charge-offs in Q2 and the lower read through, I feel pretty good about what we have seen so far. That's the first thing.

The second thing is in response to your question, we did. We obviously took a reserve this quarter of 30 million in excess of the charge-offs that, 22.3. So we took a reserve in excess of what the charge-offs were. And I think as Rob said in his prepared remarks, we would expect to take those kinds of similar reserves, or theoretically even a little more, again expecting that the charge-offs will be less than the reserves as we move through the second half of the year in Q3 and Q4. But given the shape of the yield curve, given what we're seeing in terms of customer engagement around cash, around DART, around margin, given what we're seeing in terms of controlled expenses, as an offset we believe that we weren't comfortable with the range continuing at the midpoint of about 65 and then tightening the range $0.03 in either direction.

<**Q – Prashant Bhatia>:** Okay. Great. And then just one final. In terms of the non-performing loans as well as the special mentioned loans that you classify, how big is that right now?

<**A – Mitchell Caplan>:** The non-performing loans were up, as I said, I think $50 million quarter-over-quarter. And – let me – actually let me look at the numbers and when we follow-up with you this afternoon, we'll give you the exact numbers, so we can be specific. And it will clearly obviously be filed in the Q in a couple of weeks. But we'll follow-up with you in advance.

<**Q – Prashant Bhatia>:** Okay, thanks.

<**A – Mitchell Caplan>:** Absolutely.

Operator: Thank you. Your next question is coming from Mike Vinciquerra of BMO Capital Markets. Please go ahead.

<**Q – Michael Vinciquerra>:** Thank you, good afternoon.

<**A – Mitchell Caplan>:** Hi Mike.

<**Q – Michael Vinciquerra>:** Thank you guys for the additional detail in your metrics, it's certainly very helpful...

<**A – Mitchell Caplan>:** Sure.

<**Q – Michael Vinciquerra>:** And gives us some more material to ask some hopefully intelligent questions. I want to ask you on the growth rate in your revenue per customer. Now, when I look at what you guys are talking about, you're seeing a better customer mix with more targeted accounts, you're seeing options growing as a percentage of the total, and your assets per customer are up about 14% year-over-year. Yet your revenue for customer is only up 5%. Can you – are we building to something that's going to see an acceleration in revenue per customer? Give me some idea about what we can expect there.

<**A – Mitchell Caplan>:** Right. Well – so, a couple things. One is, provision is up and gains are down significantly, and so there has been a huge mix when you think about the quality. I mean, one of the things I think we always got hit for was, and there was a discussion about with, the gain on sale of securities above the line. And so when you think about it, the quality of earnings have changed dramatically, and given the credit environment, our provisions are up. So, I think the metrics are reading through when you look at each individual line item, like around assets and fee-based revenue, when you look at cash and credit and you look at net interest income, when you look at commission revenue. It absolutely is reading through in all of those and it really is just a continued, and I hope, what we will continue to see the transformation around the quality of recurring revenue.

<**Q – Michael Vinciquerra>:** Well, with gains now being only 5 million for the quarter, does that tell us that maybe we should see some acceleration, because you won't have that headwind going forward, at least on this particular metric, revenue per customer?

<**A – Mitchell Caplan>:** Yes, agreed.

<**Q – Michael Vinciquerra>:** Okay, all right. And then I want to ask a question on the – and you guys get this a lot and I hear it from our clients a lot as well. But the funding mix at the bank...

<**A – Mitchell Caplan>:** Yes.

<Q – Michael Vinciquerra>: Big growth this quarter, 9% sequential growth in the average balance sheet. And when I look at your three main funding categories, retail deposits rose 8.4%, repos and other was up 12 and FHLB up 23. The last two of those being your highest cost sources. Is there any thought process to not growing those types of...

<A – Mitchell Caplan>: Yes.

<Q – Michael Vinciquerra>: Categories, and then just letting the retail deposits drive it even if it means slower balance sheet growth?

<A – Mitchell Caplan>: Yes, 100%, and you will hear more from us about that. But let me set context. First of all, what you're looking at is average balances as opposed to ending balances. So when you look at ending balances, it's smaller, right? Because again, as I said, we were out of some of the securities that we bought in the beginning of the quarter in preparation for adding the loans based on the growth in cash balances. So, again, we had originally modeled and what we had seen, was going to a place where – although we ended at 1.9 billion in cash, up from – I guess whatever it was – 300 million a year ago, we had really seen it closer to the 2.5, 2.7 moving towards 3 billion before the net buy.

So, as we really were planning for the quarter, in many respects if you look at the growth ending balance-to-ending balance, it was up probably a little over 3 billion and we would have presumed that a significant portion of that would have been done close to 2.5 or 2.7 around cash, but for the net buying that we saw. So strategically what you're describing is exactly the direction that we're going in as we think through both the remainder of this year, and certainly I think you'll hear more from us as we go through '08. We would expect to see retail being the driver for the balance sheet, freeing up capital. And as a result of freeing up capital, continuing to use it for things like fairly significant share buybacks.

<Q – Mike Vinciquerra>: Okay. That's great. Thank you. And then just one last thing. Your NIM held up very well in the quarter, and I notice your transaction accounts were up very, very nicely. Can you give us a sense for mix between max-rate checking versus...

<A – Mitchell Caplan>: Absolutely.

<Q – Mike Vinciquerra>: -- money market mutual funds?

<A – Mitchell Caplan>: Love it, great question. So again, as I said to you, I think the incremental cost of funds in all of retail deposits was about 3.86%. 3.68, sorry I was reversing it. So at 3.68, obviously it's not all at the CSA of 5.05 or 5.10. So what you saw was, you saw growth in free credit, you saw growth in sweep, and you saw growth in transaction. And within transaction you saw a nice mix between things like max-rate checking and money market which have a lower cost of funds in addition to your CSA account which has a higher cost of funds, which resulted in a blended basis across all retail deposits of this 3.68 incremental. So again, to your point, yields remained flat quarter-over-quarter. You might have otherwise expected them on the asset side to be up a bit given the shape of the yield curve. I think, one of the things that we said, if I remember correctly, I'll go slowly in this. In December of last year, we said that if the yield curve between Fed funds and 10 years for every 10 basis points of steepening, you would see about a penny and a half on an annual basis of value to the bottom line. So although period end to period end Fed funds to 10 years between Q1 and Q2 was up 25 basis points. Most of that occurred in the last month of the quarter. So clearly, we would be benefiting from that shape of the yield curve going forward. Some of that benefit was offset by making the economic decision to literally reduce your consumer portfolio, reduce your HELOC portfolio within your mortgages, and move, as I said, exclusively to 100% acquisition of single-family first lien mortgages. And so net-net, your asset yield stayed flat quarter-over-quarter, and your cost of funds, if I remember correctly was up 3 basis points, keeping our spread pretty stable and squarely within what we guided to in December of last year, I think, at 265 to 275.

<Q – Mike Vinciquerra>: Great. Good stuff. Thanks, Mitch.

<A – Mitchell Caplan>: Absolutely.

Operator: Thank you. Your next question is coming from Mike Carrier of UBS. Please go ahead.

<Q – Mike Carrier>: Thanks, guys. Just another question on the credit side. Clearly there is not much differentiation in the market, just in terms of the different portfolios. I am just trying to get a sense like when you say next quarter and for actually the second half of the year, that the provision will continue to be a little bit higher than we are at now, and net charge-offs should continue to grow higher. I am just trying to balance like, last quarter was kind of at the 25 million level.

<A – Mitchell Caplan>: Yes.

<Q – Mike Carrier>: And now we are up to 30 million. Just making sure like if your expectations over the next 12 months, like where they are given the portfolio...

<A – Mitchell Caplan>: Great.

<Q – Mike Carrier>: That too, every quarter we're not going...

<A – Mitchell Caplan>: Great, great, great question. So I think a great way to think about this is that if consensus was at $1.65 or $1.64 or whatever for the year, which was sort of the mid – where we were in terms of the midpoint of our guidance. Clearly in delivering 42 cents, given that consensus was at about 40 cents for the quarter, we exceeded that by about 2 cents. We could clearly have let that read through in upping our guidance for the remainder of the year, moving the consensus up by 2 cents. In addition, I think, we are seeing, as I said, some of the benefits now from things like customer engagements, the shape of the yield curve, relatively controlled expenses. And in our mind what we are saying is that we think, given the macro-environment, notwithstanding that again what we are only seeing is 2% or under in terms of the kinds of loss or loss mitigation around the HELOC portfolio, which again is in the NPLs only at about 96 or 98 million, that we think that the prudent thing to do is continue to – given the strength of the earnings, to continue to build our reserve. So again, if you think about each of those 2 pennies or 7 million going to Q2 and – Q3 and Q4 off of our guidance, it would tell you that you could see off of the original thing that it was going to be 25 in Q1, but again you could be at 32, 33 million in each of the two quarters. One may be a little less, one may be a little bit more, but that's probably sort of the general direction.

<Q – Mike Carrier>: Okay. And then just on the...

<A – Mitchell Caplan>: Does that help?

<Q – Mike Carrier>: Yes. That was helpful. And then just on the equity side, just on the AOCL, similar like kind of concept, meaning what's in that portfolio? Like how can we get our arms around – what's related to rates versus what's related to like credit, mark-to-market?

<A – Mitchell Caplan>: In what, I am sorry?

<Q – Mike Carrier>: On the balance sheet in the equity side, the AOCL.

<A – Mitchell Caplan>: Oh, yeah, that's not loans, it's all...

<A – Robert Simmons>: The movement in AOCI in the quarter is purely related to the securities mark, that goes through OCI.

<A – Mitchell Caplan>: Right. There is nothing in the loans in there, and it's – and when you look at our securities portfolio, I think, as we have said, 98% of them are AA and AAA.

<Q – Mike Carrier>: I mean, I understand that. I am just saying like when you think of the AA, AAA, that's been a big issue in the market, meaning what's really AAA versus what's been polled as AAA?

<A – Mitchell Caplan>: Right. And we will – again, I guess, we test for impairment, and we do all that kind of stuff. And if there were any issues on impairments, it would be moving through our P&L. So...

<Q – Mike Carrier>: Okay.

<A – Mitchell Caplan>: When you look at our portfolio, it really is mostly agency paper, Fannie, Freddie...

<Q – Mike Carrier>: Okay.

<A – Mitchell Caplan>: I mean, that's really the gist of it. So I guess, if we start seeing...

<Q – Mike Carrier>: Yeah. We are all in [inaudible]. All right. And then just finally on the international trading, I know back at the analyst day, you mentioned on the FX segment of that, I am just hearing like internally from our guys on the FX floor that the amount of revenues or the amount of volume on the retail side is just phenomenal.

<A – Mitchell Caplan>: Yeah.

<Q – Mike Carrier>: And so I am just wondering like when you start having that international, is there – can you strategically have like an FX operation to compete with some of the online brokers that just focus on FX?

<A – Mitchell Caplan>: Yes. I understand the question. Jarrett?

<A – R. Jarrett Lilien>: What we want to be careful about actually – and let me take a big step back, in some of our international locations where customers are more accustomed to trading currencies, we actually have FX-trading product. In the US, that's not really the case. And in the US, when you look at the online players that let people play FX, it's really a model of a revolving door sort of get a customer in, let them trade, blow up, and get a new customer. What we are looking to do with our US model in FX is have it be a product extension that enables people to play the foreign markets, to invest in the foreign markets. And last week, we launched our global trading product to all of our customers here in the US, letting them trade in 6 non-US markets, 5 non-US currencies. FX is a nice piece of it, and so far we have had good results for the first week, but it is interesting the FX piece of it even when we are not encouraging people, they are using the FX facility to transfer money, for instance from dollars to yen, so they can buy stocks in Japan. Still it's a nice business with a nicer margin, and actually generating about 2 times the margins than we are seeing on the equity commission. So it's a different approach, but it's one that's sustainable, because it's one that enables our clients to be more successful rather than just a new trading product that entices them to blow themselves up.

<Q – Mike Carrier>: Okay. Thanks a lot.

<A – Mitchell Caplan>: Absolutely.

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

<Q – Michael Hecht>: Hey, guys. How are you doing?

<A – Mitchell Caplan>: Hey, Michael.

<Q – Michael Hecht>: Just a few quick follow-ups, I am hoping to get a little more color on the strength in the service charges and fees you talked about this quarter. I mean, how much is kind of coming from account service fees or maintenance fees for an activity which you guys still charge, but a lot of your competitors have eliminated versus just core growth in fee-based assets?

<A – Mitchell Caplan>: Great question, account service fees for us in terms of earnings are down quarter-over-quarter. The growth that you are seeing in the revenue is coming from the mutual funds and the related asset products.

<Q – Michael Hecht>: Okay. helpful. And on the flows, I know you guys have been beating up that disclosure, so thanks, that's helpful. The 1.6 billion in flows you saw in the second quarter, I am just trying to get a sense, I mean, if we think about it, you guys are doing about as much inflow in a quarter as Schwab probable does in about a week. So, can you help us understand how – why you guys are lagging Schwab so much? And then when you look at the increase...

<A – Mitchell Caplan>: We're about 10 years younger.

<Q – Michael Hecht>: Well, you would think with a smaller base, you would actually have a higher organic growth rate, but it's actually lower. But if you think about the increase you had in cash balances, it's more like 1.9 billion and 1.6 billion overall. How do we think about what types of products your investors are actually pulling money out of or that is...?

<A – Mitchell Caplan>: Yeah. You can't do it, because its apples and oranges, right? So the idea is one of them is net asset inflows, and the other one in terms of the cash balances are absolute growth in cash. So you can't – it's a different form of calculation, and I am sure that afterwards I am happy to or Adam is happy to walk you through the difference between those two calculations. So when you look at the 1.6, and you look at the – what we brought in, in Q1 versus Q2, I think, we were down on the exact same percentage that Schwab was down between their Q1 and their Q2 given probably the seasonal outflows that you see with taxes. And again, we are starting to see growth. We are 213 billion in assets. It's a record for us, and the highest that we have ever been. And I think, we are finally starting to make headway. We are just in a place where, as I look at our model, it was only as we got through Q1 of this year now into Q2 as we are going into Q3 that I think we are really seeing the returns for the investment and the growth in the target segment, then you would hope to accelerate the growth in assets.

<Q – Michael Hecht>: Okay. Maybe on that point on kind of tax seasoning, can you help – or any more color on kind of slowing deposit growth towards the end of the quarter, and I think, you saw about a $57 million increase in June. You got about a $0.5 billion increase in April which I thought would have been the heavy tax outflow month, anything going on there?

<A – Mitchell Caplan>: Again, I think, what you are probably looking at is the balance sheet, which is the bank balance sheet as opposed to the whole integrated customer cash.

<Q – Michael Hecht>: So, that's everything? That's all of the cash flow balances added together?

<A – Mitchell Caplan>: I don't -- yeah. I don't think so.

<A – Robert Simmons>: The cash number you get on a monthly basis is just the deposit piece of it, Mike, as you know there is another piece that's sort of the brokerage or unswept or money market fund piece. So you've to actually – you get that data on a quarterly basis, so when you add those two together you are going to see the total change in customer cash. On a month-to-month basis, you are getting sort of half the equation.

<A – Mitchell Caplan>: Right. You are only getting what runs through the bank's balance sheet.

<Q – Michael Hecht>: Okay. All right. And then just one other metric I wanted to follow-up on, despite this growth you are talking about in kind of targeted customers. The cross sell rate that you guys disclosed the number of products per customer's feedback is like 2.1 for a while here. What's going on there and what do you think it is going to take to start seeing some increase in that?

<A – Robert Simmons>: Yeah. Mike, let me – it's Rob here, let me take that one. This is a number that takes our total customer base, and as you know, we have now gone through a process of giving a lot more visibility to the segmentation around that both on the analyst day and in fact, in this earnings release that you see. So, when you look at the account segmentation detail, you can see that we have about a million corporate services accounts that by definition will only have one product associated with those for the time that they are waiting for their options to vest. So when you calculate it excluding some of the other accounts like corporate services that if you look at it on a target segment account, which would give you a lot of the ability – it would give you the ability to do that for the most part. The story gets a lot better, you get closer to 2.5 or closer to 3, so we're very pleased with the engagement. The mechanics of that particular metric is one that we are actually looking at, and we might revise that next year.

<A – Mitchell Caplan>: So if you looked at it, my recollection is it has grown in target segment from like 2 to 2.7 or something like that. So, you have seen significant growth.

<Q – Michael Hecht>: Okay. Got you.

<A – Mitchell Caplan>: And up year-over-year.

<Q – Michael Hecht>: Right. Okay. And just last question. Just to help me think about comp expense, from here I mean it's down nicely quarter-over-quarter, year-over-year as a percent of revenues, I mean, despite the investments you guys are making – I think, you talked about improving kind of service levels. How sustainable do you think that level is?

<A – Mitchell Caplan>: I think, we have always guided to starting in December, and we haven't changed anything – to 18 to 19%. And so fundamentally, what we are doing is we are continuing as we said to grow head count in the areas of service and head count is decreasing in other areas through continued use of technology and efficiencies. Right. So we continue to be more efficient in the core areas of operations, and processing, increasing our incremental op margin, and at the same time, we are making the investment in the head count around service. And again we've done that now. I think, we started literally a year ago by telling you we were going to make that 40 million investment. We made it. We continue to have the head count. We continue to grow it, and yet you are seeing comp and benefits come down as a percentage of revenue, and I suspect you will again see it stay in that 18 to 19%, and I think you will also see growth in the area of service.

<Q – Michael Hecht>: Okay. Great. That's helpful. Thank you.

Operator: Thank you. Your next question is coming from Roger Freeman of Lehman Brothers. Please go ahead.

<Q – Roger Freeman>: Hi. Good evening.

<A – Mitchell Caplan>: Hey, Roger.

<Q – Roger Freeman>: I wanted to – just a couple of follow-up questions on the lending side. The – what percentage of your HELOC loan balance is to customers who you also hold the first lien with?

<A – Mitchell Caplan>: Virtually 100%.

<Q – Roger Freeman>: Okay. So that puts you in some control in a foreclosure process. And then I guess the other question I have is what – when loans due to fall – or actually what percentage of your loans are to customers you also have brokerage – that also have brokerage accounts with you at this point?

<A – Mitchell Caplan>: I don't – the originated loans to brokerage customers, we don't break it down. Okay. We don't break it out. We don't break it out.

<Q – Roger Freeman>: Do you have I guess the question I want to ask is when a customer defaults on a mortgage, that has – do you have – they have a brokerage account with you, do you have the ability to seize assets in a brokerage account as collateral, or does it not work that way?

<A – Mitchell Caplan>: No, you do not.

<Q – Roger Freeman>: Okay.

<A – Mitchell Caplan>: You do in their bank account, so if they have a bank account with you, you have the ability to seize it. You don't have the ability in a brokerage account.

<Q – Roger Freeman>: Okay. Do you do that?

<A – Mitchell Caplan>: We do.

<Q – Roger Freeman>: Okay. And then third question, the decision to keep more of your whole loans on balance sheet, I mean, how – what is driving it? Is it the prices that you can get in the secondary market have gone down, I guess, with more risk being priced in? Is that part of what we are seeing that the gains on sales are decreasing as a function of the decrease in pricing in the market?

<A – Mitchell Caplan>: I think, it's more that strategically we said – so if you go back and you historically look at our business in terms of originating loans to customers in the mortgage world a couple of years ago, 4 or 5 years ago, it really was around refinancing. And as we moved out of the refinancing boom, we realized that the amount of loans that we were originating dramatically decreased to literally the 100s of millions in a quarter. And ultimately, we repositioned the whole business, and said the goal in originating mortgages is to originate them to our customers and put them on balance sheet and hold them on balance sheet. So that is each quarter we have directionally tried to originate and hold a bigger and bigger percentage of what gets originated on balance sheet. And so as a result of that when you look at this particular quarter what you actually see is, if I remember correctly, I think, it's 5 million. The breakdown when you look between retail and institutional is like a positive 7 and a negative 2 in institutional, and the reason that's the case is that when you actually get the Q, I think, what you will see is that institutional made about $3 million, and retail made about 2 from selling into the secondary market. And the reason that retail shows reads out as a negative 2 is that they are paying $5 million. Institutional -- sorry, as they are paying a positive $5 million to retail to originate a mortgage which can be put on balance sheet where the economic return will read out and spread over time as currently in gain on sale. So the decision is always made at that moment in time when you look at the origination, are you better off putting it on balance sheet because of the economics and have it read out over time and spread, or you are better off in selling. And so as we have been originating more of the kind of assets that we want to hold on balance sheet which will read out in a better spread, there has been less sale into the secondary market, therefore less gains.

<Q – Roger Freeman>: Okay. That's helpful. And I wanted to ask you on the – in the investment portfolio, I think you have something in the neighborhood of $2 billion in asset-backed securities...

<A – Mitchell Caplan>: Yeah.

<Q – Roger Freeman>: aside from your MBS holding.

<A – Mitchell Caplan>: Yeah.

<Q – Roger Freeman>: What percentage of that is in ABS CDOs, and what percentage of that is AAA rated?

<A – Mitchell Caplan>: The vast majority, again 97 or 98% is – the vast majority of it is AAA rated. Let me get back to you with the specifics, when I have looked at it.

<Q – Roger Freeman>: That's fine. We can follow-up on that later.

<A – Mitchell Caplan>: So about 20% of it is in – of the asset-backed are in CDOs, and again they are all AAA rated. Yes. That's right.

<Q – Roger Freeman>: Okay. So some of the other categories would be, what, CLOs or what would some of the other 80% be?

<A – Mitchell Caplan>: No. It would be sort of traditional AAA rated ABS portfolio. And what I'll do is simply follow-up on the call with you, I will give you...

<Q – Roger Freeman>: Okay.

<A – Mitchell Caplan>: -- some more specific if you would like.

<Q – Roger Freeman>: That's helpful. All right. Last question, quickly. You made an interesting comment on the increased use of options as a hedging strategy. I am curious, Mitch, is that – do you see that more as a function of the cost to hedge has come down, because of increased liquidity in the options market or is it a more defensive measure on the part of your customer base, given volatility in the market? Or maybe both?

<A – Mitchell Caplan>: Well, it's more of just a more sophisticated customer. I mean, if you really do go back 5 years ago when it was only about 5% of DARTs then it was really used as a speculative tool and most customers were actually a little bit afraid of options. What you've got today with a lot of option education is it's not only hedging it's also yield enhancement, and what's really nice about it as we mentioned in the remarks is it's being used by more and more of the customers. So I don't think it's really anything that's happening in the market and the liquidity or the cost as much as it is education and a broader segment of retail understanding how they can use options to their benefit.

<Q – Roger Freeman>: Okay. Thank you.

Operator: Thank you. Your next question is coming from Howard Chen of Credit Suisse. Please go ahead.

<Q – Howard Chen>: Hello?

<A – Mitchell Caplan>: Hey, Howard.

<Q – Howard Chen>: Hey. Given the environment, I just wanted to make sure I am clear on management's message on asset quality. I guess, first, if I back into the non-performing loan figure, it looks like you ended the quarter with 168 million of NPLs, which I guess is roughly 50, 52 million up from the first quarter level. Is that roughly about right?

<A – Mitchell Caplan>: I think, it's up about 49 million, as we said, yes.

<Q – Howard Chen>: Okay. So I guess, Mitch, given your fairly constructive thoughts on the credit outlook versus what we are hearing in the industry, I am just trying to get a better feel on credit management. A $7 million reserve build seems to make sense in the environment, but if NPAs were up 50 mil, 49 mil in the same period, I guess, that would imply that the reserve coverage fell to something in the 45% range. So what gives you the confidence that this is the appropriate reserve? I hear you with regards to just being flexible with regard to adjusting that going forward, but just wanted to get your feel right now?

<A – Mitchell Caplan>: Yes, okay. So as you look at where we are right now and we look forward in terms of 12 months of losses or four quarters worth of losses, there are probably two significant things that get us extremely comfortable with where we are. The first one is that when you look at what actually is reading through as I said there is with a reasonably strong improvement in Q2 given that when you think about the pipeline from Q1 what read through was down from 26% to 19%. And again, I think, we are seeing that because some of the customers who had been moving into the NPL pipeline before they were actually getting to charge-off are actually getting refinanced and taken out. Not by us, but I guess by others. And so given that we feel that we are pretty comfortable with seeing sort of the 19% range. That's the first thing.

The second thing is we are fundamentally changing the mix. So in other words, we are continuing to allow consumer to bleed off as we always have. We are continuing to let HELOC and others reduce, and we're doing literally, as I've said, 100% of the buying in first lien position mortgages which tradition has had about a basis point of charge-off for us.

<Q – Howard Chen>: Okay.

<A – Mitchell Caplan>: So when you think about those two things, we believe that the current quality of our portfolio is better than the average there. And you see it when you look at us compared to the industry at large, when you see other metrics from the thrift industry or otherwise. And we also believe that we are going to make some significant changes. That said, I think, what we are clearly saying is we don't believe that we are immune. And so if you look at this quarter, given what we saw in terms of charge-offs only going up 1.5, we increased reserves by 9 million and we went to 30 million. And even in the context of reaffirming the guidance and the range, we had said that we do believe that we will likely take – within that guidance context – likely take reserves up in Q3 and in Q4. Not withstanding the fact that charge-offs may in fact be less than those reserve levels.

<Q – Howard Chen>: Okay. That's helpful. I guess – and thanks for reviewing that. I guess, it's still early in the third quarter, Mitch. But with regards to that first point, that 26 to 19%, does that still – do those trends still hold true in the early parts of July?

<A – Mitchell Caplan>: I guess from what we can see so far. Again, it's hard to know because where we keep – we do calls with them, and we have actually people on site managing it. So...

<Q – Howard Chen>: So...

<A – Mitchell Caplan>: ...we have, we think, to change that, yes.

<Q – Howard Chen>: Okay. And then earlier in July, Moody's downgraded the rating of E*TRADE CDO I. I know you took it write-down to this one in the third quarter of last year. But can you just update us on any remaining exposure you may have to that manufactured housing CDO? And then your view on the outlook for the remaining CDOs that you have, and what you're actually doing there?

<A – Mitchell Caplan>: Yes. So a good way to think about this is that the CDOs that we had originated I think are through CDO I through VI. We held a residual in CDO I which we wrote down to zero. So – and we did that last year. When you look at the rest of the CDOs, we are holding all of them right now at book value. And the total book value for 100% of CDO I to VI is $11 million.

<Q – Howard Chen>: Okay. And then that book value, would that have changed from let's say like a quarter ago?

<A – Mitchell Caplan>: No.

<Q – Howard Chen>: Okay. And then finally, Mitch, just switching gears. We are now a few quarters into the launch of the loan optimizer. It seems like your margin loan balances are tracking higher.

<A – Mitchell Caplan>: Yeah.

<Q – Howard Chen>: But from what you can see, is it at all a function of your customers shifting their leverage away from HELOCs or credit cards to margin loans? Or is that simply just a function of overall equity market appreciation? I guess, put another way, are you happy with the way that the loan optimizing is progressing?

<A – Mitchell Caplan>: Yes. Yes. But again, it's early days and so we would hope to continue to see – has the loan optimizer been as successful as the cash optimizer? No. But again, it's early days and we expected it to take longer. When you think about the growth that we experienced in margin in this past quarter, and again I think, what we've seen so far in Q3 we think that most of that is driven, whether it's the loan optimizer or otherwise by continued engagement within the target segment.

<A – R. Jarrett Lilien>: Yeah. And the thing is the loan optimizer is a good awareness tool right now, and it's doing its part. But just reiterating what Mitch said, I mean, the real growth is additional accounts. I mean, it's the growth in the target segment that's driving – drives 76% of our revenues. It grew 29% in the quarter. That is what's driving assets, cash, DARTs, and margin.

<Q – Howard Chen>: Okay. Thanks, Jarrett. Thanks, Mitch.

<A – Robert Simmons>: But let me clarify one other point that was made earlier by Mitch, and it was question around vintages and stuff. I think, if you look at our total loan book as of the end of this quarter, you can see that the growth in our loan book came prime – came exclusively in 1-4s and margin, which are our highest quality loan categories. If you look at our consumer and our HELOC book, they were both down. So the question with respect to vintages, we don't have zero in '06 vintages in our book, but we'll give you some more details when we file our Q. But I just wanted to clarify that the reduction of $400 million related to our HELOC book this quarter, and we would expect that sort of trend to continue.

<A – Mitchell Caplan>: Right. And I guess what I was responding to was what [inaudible] next to me was talking about, which is within the '06 vintage, we have zero in sub-prime. And so I think that was the issue that I was responding to, and I guess the sheet of paper that I had been seeing. So again, our sub-prime quarter-over-quarter continued to stay flat and declined a bit. And then what could be thought of as sub-prime, I guess, in the '06 vintage is zero according to that.

<Q – Howard Chen>: Thank you.

Operator: Your final question is coming from Matthew Fischer of Deutsche Bank. Please go ahead.

<Q – Matthew Fischer>: Good evening, guys.

<A – Mitchell Caplan>: Hey, Matt.

<Q – Matthew Fischer>: The global trading platform, so you fully launched it last week...

<A – Mitchell Caplan>: Yes.

<Q – Matthew Fischer>: Does any of the two have – second half guidance include – does it include much, if any, contribution from that?

<A – Mitchell Caplan>: No.

<Q – Matthew Fischer>: Okay. And at what point do you start to see some activity and some of the usage rates increase? And are you already seeing some of the beta people start to be – become more active users?

<A – Robert Simmons>: Well, there is some global trading activity built into the second half. It's just that we're not betting right now on an avalanche. And if we start to get a huge pick up, which I believe one day we will get and actually part of me believes that it will come in an avalanche at some point, just the way the online trading was adopted or adapted in the US. People overnight all of a sudden wanted to trade online in the US. We have built a measured increase in global trading into the second half budget. No incredible upside. I think, what you're going to have more likely is that what we will build into our numbers is a nice gradual increase. We're seeing that early days so far, the data customers picked up activity. A lot of new customers came in. Another interesting thing that we saw in the marketing that we have done around it is that some of the increase in new accounts in general has been driven by global trading platform advertising. It is one of the more newsworthy things, and when we advertise behind it and do promotions behind it, people are clicking through there and oftentimes starting up by just opening up a US account.

So a lot of the results are very positive, but are showing up in other places right now. And I would add one other place where the positives are yet to turn up, which is what it does for us on the infrastructure side. In time, what we would like to do, and we have talked about this before, is have our non-US platforms replaced by our global platform, and that will help us increase efficiency and reduce costs. And an example for instance would be in Hong Kong today we have a platform, we have customers in Hong Kong, but our US platform trades the US, it trades Hong Kong. Why can't our Hong Kong customers trade through essentially the US platform or the global platform for Hong Kong, for the US, allow us to eliminate the Hong Kong platform completely; again, increase efficiency, reduce costs, and really gain scale advantage. So there are advantages of this platform left and right. They will show up throughout the business, and so far we are extremely pleased with the results.

<Q – Matthew Fischer>: Okay. And then the other piece is the UK bank charter. Any...

<A – Mitchell Caplan>: Yes. Happy to do it. So the answer is we are in great shape. One of the things that we learned about in the process of actually filing for the UK bank charter was that we did not need an independent bank charter, but instead in working with the FSA, we could simply apply for an extension of our current license to not only be a brokerage and bank. We have cleared all the hurdles, and we have already started taking cash deposits. And in fact, if I remember correctly, cash deposits internationally were up 15 or 16% quarter-over-quarter. 17% quarter over-quarter-quarter.

<**Q – Matthew Fischer**>**:** So you are already – got it up and running? When do you start to really market some of the bank products abroad?

<**A – Mitchell Caplan**>**:** Again, that will be the next step. The goal here is rather than to necessarily spend the marketing dollars directly for a bank product in the UK and all the related EU countries is to market it as part of an overall investing offer, exactly as we do in the United States. And so right now, we are doing it mostly through service and calls. We have done a little bit of advertising in some of our international locations, but as we continue to move forward with the international strategy and marketing, you will see an offer that will include a host of things, one of which will be cash, just as we do in the United States.

<**Q – Matthew Fischer**>**:** Okay. And when you say down the road, are we talking an '08 or are we talking second half of this year to start really taking advantage of this – now this the fully integrated international platform?

<**A – Mitchell Caplan**>**:** Well, I think, it just depends again on how we allocate the marketing spend between the US and international, but to the extent that we see the kind of growth, then we will allocate the dollars internationally. I mean, I think, that's exactly what we are thinking about trying to do, and we are seeing a pick up in cash growth internationally.

<**A – Robert Simmons**>**:** But you also – you have your long-term vision, which for us is global financial services. And global financial services includes investing and trading, cash management and lending. So that's your long-term vision, you need to build a brand in that direction. And then you have got your short-term opportunities, and I would say that we are more efficient and effective with our marketing dollars than almost anybody, which means being opportunistic, looking at what's going on in the market and marketing to what the market demands at that time. That's what's going to drive short-term marketing dollars. Long-term branding and marketing dollars are going to be around global financial services.

<**Q – Matthew Fischer**>**:** But I guess you have to kind of develop different marketing products for each region?

<**A – Mitchell Caplan**>**:** Yeah. The products actually can be pretty similar because you are using the charter that you have through the FSA and extending it, and so then it goes to the issue of the currency, and because we have FX because of trading, it's not complicated. It's not that complicated for us to do.

Really, it's building, as Jarrett was saying, the brand outside of the US just as we have done inside the US to go after this investing customer, and then as you are going after the investing customer, building the total relationship with them, including cash.

<**Q – Matthew Fischer**>**:** Okay. That's good. And I think, everything else has been answered already. Thank you.

<**A – Mitchell Caplan**>**:** Great.

Operator: I'll now turn the call over to Mitchell Caplan for any closing remarks.

Mitchell H. Caplan, Chief Executive Officer

Great. Thanks everybody for joining us on the call. We look forward to following up with you after our Q3.

Operator: Thank you. This does conclude today's teleconference. You may now disconnect your lines at this time, and have a wonderful day.