MANAGEMENT DISCUSSION SECTION

Operator: Welcome to E*TRADE Financial Corporation’s Third Quarter 2007 Earnings Conference Call. [Operator Instructions]

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 periodically filed with the Securities and Exchange Commission could cause the company’s actual results to differ materially from those indicated by its projections or forward-looking statements.

This call will present information as of October 17, 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 found on its website at etrade.com.

This call is being recorded. Replays of this call will be available via phone, webcast and podcast beginning today at approximately 7PM Eastern time. This call is being webcast live at etrade.com. No other recordings or copies of this call are authorized or maybe relied upon.

I'll not 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, everyone, and thank you for joining us for our third quarter conference call. As you are all well aware, the credit markets experienced unprecedented disruption during the third quarter creating an extremely challenging environment. The volatility in the credit markets, declining home prices, and the repricing of risk drove wider credit spreads. This led to increased default rates, losses, and reduced liquidity across mortgage-related assets throughout the industry. While we continued to generate strong, and in some respects record results in our retail business, the success of the core franchise this quarter, was over shadowed by volatility in the credit markets.

As the mortgage industry deterioration spread from the sub-prime market, and began to impact the broader financial environment, we worked quickly to analyze various scenarios based on assumptions derived from the data available to us. Based on this analysis, we made the decision to revise our annual earnings outlook on September 17. Along with the revised guidance announcement, we introduced a strategic plan to accelerate our balance sheet restructuring initiative and exit underperforming businesses. This plan was designed to improve earnings quality, expand company-wide profitability, and increase return on equity over time.

We also outlined our expectations for potential securities related impairments and provision for loan loss levels for the remainder of 2007 and throughout 2008. Our forecasts were set against expectations of further deterioration in the credit and residential housing markets and that continues to be our view.

As a part of our guidance release last month, with respect to securities impairments, we forecasted that we could see up to $100 million in the second half of 2007 and an additional 50 to 100 million in 2008 for a total of up to $200 million over 6 quarters. These impairments were primarily related to two categories within our asset-backed securities portfolio, which we identified to have the
highest risk. Specifically, these were collateralized debt obligations or CDOs and securities collateralized by second lien mortgages.

Since the September guidance release, upon re-evaluation and refinement of our forecast, we determined that certain write-downs needed to be taken in the third quarter. Additionally, we decided to accelerate the sale of the highest risk portions of these portfolios, writing-down securities rated lower than AA by more than an average of $0.50 on the dollar. By changing the intent and designation to no longer hold these securities to recovery, the combined effect is that we recorded an impairment charge of approximately $197 million in the third quarter.

While the fixed income market continues to be incredibly challenging, we have seen some evidence of stabilization in certain pockets and the action we have taken will allow us to exit these securities as opportunities arise. The decision we have made is also consistent with our focus on reducing the securities portfolio as soon as reasonably possible as we transition the balance sheet toward retail driven assets and liabilities.

The realization of these impairments in the third quarter is to the benefit of future quarters. While of course this does not guarantee that we won’t see any other impairments going forward, we believe that we have reduced the current risk in our two highest risk ADS categories significantly relieving headwinds to the performance of the Company in the fourth quarter and into 2008.

We have provided an update to our supplemental portfolio disclosure document to reflect data as-of September 30. The document will be available later this evening on the Investor Relations section of our website at etrade.com. On page 24 of that document you can see the impact of the impairments.

In our whole loan portfolio, performance trends of mortgage loans, specifically within home equity loans, remains challenging but fairly consistent with our previously revised expectations. Total delinquent mortgage loans increased to $769 million, up from 548 million in the second quarter. Non-performing mortgage loans, which is the subset of total delinquent loans that are delinquent by 90 days or greater, increased to $266 million from $164 million in the second quarter.

It’s important to note that 43% of our non-performing mortgage loans are related to 1-to-4 family, where despite the increase in delinquencies in these loans we continue to see net losses in the rage of 1 to 2 basis points. This is the result of excess collateral due to relatively low loan-to-value ratios and mortgage insurance coverage on loans with loan-to-value of greater than 80% at origination.

Consistent with our revised guidance announcement in September, the provision for loan losses was increased significantly quarter-over-quarter to $187 million. This increased our blended coverage of non-performing loans to 76%. Embedded in this ratio is coverage in excess of 100% of non-performing loans in the categories of highest expected losses specifically, home equity and consumer.

In our core retail franchise customer engagement and growth trends remained robust and were particularly impressive for the summer months. We delivered continued account growth with the most significant increase occurring in our target segment, which now represents approximately 28% of our retail accounts, passing the 1 million mark for the first time.

As a result of the continued improvements in the quality of our overall account base, we generated solid growth across all the key drivers of the business including: accounts, trades, assets, cash, and margin borrowing. We are extremely pleased with the continued growth trend throughout the retail business but we are clearly disappointed with the overall company performance.
For the third quarter, we reported a net loss of $58 million dollars or $0.14 per share including the
$0.30 impact from the securities write-downs I already discussed. While we recognize that we
cannot control the macro economic environment, we are aggressively addressing the current credit
challenges we’re facing.

In accelerating the timetable to reduce our asset-backed securities portfolio, we are working to put
the distraction of portfolio losses behind us and concentrate on the growth we continue to generate
with the retail customer. To discuss these growth trends in more detail, I’ll now turn the call over to
Jarrett.

R. Jarrett Lilien, President and Chief Operating Officer

Thanks, Mitch. The retail business delivered strong organic growth and record results in the third
quarter. Our integrated model continues to drive strong customer engagement across our suite of
products meeting our various customers financial services needs and we’re proud of these results.

Retail segment revenue was up 21% versus a year ago while Retail segment income grew 55%.
This was driven primarily by continued account growth in both investing and banking accounts,
which in total were up 6% year-over-year. Notably, this was led by year-over-year growth of 24% in
our target segment accounts including 16% annualized growth in the seasonally slower third
quarter.

We continue to see success in attracting new accounts as well as deepening engagement with
existing accounts to increase share of wallet. Our existing and new investing and trading
customers opened 60,000 deposit accounts in the quarter. This represented approximately 64% of
the new deposit accounts open in the quarter and 78% of the assets in these accounts. 80% of our
investing and trading customers that opened a deposit account increased their total assets with us
showing broader engagement trends. Assets per customer in the quarter increased to a record
$61,000.

In the third quarter, we saw positive customer activity on all fronts. Our customers were net buyers
in the quarter, and trading volumes increased to 194,000 DARTs. This was record activity for a
summer quarter, increasing 15% sequentially and 44% year-over-year. Average margin debt also
increased to $7.7 billion, an 8% sequential increase and 16% year-over-year. On top of putting
more cash into the markets, customers also grew their overall cash balances by $1.7 billion, up
25% year-over-year to end the quarter at a record $39.6 billion.

Cash balances increased nearly across the board with continued growth in our lowest cost sources
such as the Sweep Deposit Account, along with the continued success of our more competitively
priced products such as the Complete Savings Account. These positive customer metrics including
growth in accounts, assets, trades, margin and cash, are particularly important this quarter given
the disruption in the credit markets and the impact that this has had on the perceived stability of our
business. We have worked diligently over the recent months to increase communication with our
customers, and their continued engagement demonstrates their support and confidence in the
Company.

International retail activity was also very strong in the quarter, up 20% sequentially and 76% year-
over-year to a record 33,000 DARTs. We are also seeing strong growth in international customer
cash which exceeded $2 billion for the first time. These results are being driven by rapid growth in
markets such as Denmark, Germany, Canada and the UK. As a result of this success, we have
seen international revenue grow by 61% year-over-year, albeit off a relatively small base.
Nonetheless, we are delivering solid growth from our international operations with improving scale
and efficiency.
With respect to the strategic plan that we presented in September, we are making progress on all fronts. In terms of the balance sheet, average interest earning assets did increase quarter-over-quarter, and this was the result of prior purchase commitments in trade settlements.

By quarter-end, interest-earning assets declined by 1.2 billion compared to August, consistent with the plan we introduced on September 17. As part of this plan, we expect to hold the balance sheet at approximately current level and perhaps lower should we not replace assets that prepay or pay-down.

In terms of our announced exit of wholesale mortgage lending and the restructuring of the non-US institutional equity business, we are making progress. Now there has been some confusion in the market regarding our decision to exit the wholesale mortgage business and I'd to provide some clarification.

Our decision was to exit the wholesale or broker-originated portion of our mortgage operations, not mortgage entirely. The wholesale channel has historically been one source of balance sheet growth but these loans often came with little, if any, customer relationship. We plan to continue to originate mortgages directly for our exiting and prospective retail customers. As we make this transition we will continue to purchase mortgage loans in the secondary market, but only high-quality first lien mortgages consistent with our strategic initiative to reduce credit risk. We view retail mortgage as a core product with a strong link to our customers and our overall strategy.

Overall, we continue to have strong retail momentum and have reported another solid retail quarter in a very difficult and distracting macro environment. With that, let me turn the call over to Rob to discuss some of the specifics on the financials.

Robert J. Simmons, Chief Financial Officer

Thanks, Jarrett. Net revenue for the quarter totaled $321 million, down 52% sequentially and 45% year-over-year. This decline is the result of the fact that higher provisions for loan losses and securities impairments both reduced revenue. As we look to the performance of the business outside of these balance sheet related issues which Mitch already discussed, commission revenue and fee-related revenue showed solid year-over-year growth trends. Commissions grew 41% while fees and service charges grew 11%. These growth rates are primarily the result of the continued success we have driven in the retail business through the growth in our target segments.

Turning to our segment results, we can more clearly see the success of the business separating the institutional balance sheet related challenges from the retail performance. Total retail segment net revenue rose 4% sequentially and 21% year-over-year. Retail segment income grew 10% sequentially and 55% year-over-year, again demonstrating the earnings leverage and expense control in the model.

This growth in revenue and income is the result of the success we have seen in attracting, retaining and migrating more customers into our target segment. As we’ve said before, these customers on average demonstrate approximately 4 times the level of engagement around cash, assets, trading and margin which in turn drives approximately 10 times the revenue of an average customer as a result of the multiple points of interaction. Institutional segment revenue and income fell sharply in the quarter, which was a direct result of the higher provision for loan losses and accelerated securities impairments already discussed.

What’s most important is that even with these losses and the impairments, the balance sheet remains well capitalized with Tier 1 capital of 5.9% and risk-based capital of 10.6%. With respect to capital management going forward, we intend to increase our Tier 1 and risk-based capital ratios
from current levels to provide greater cushion to the well-capitalized minimum thresholds of 5% for Tier 1 and 10% for risk-based.

As previously discussed, the strategic plan we presented in mid-September will significantly reduce the capital demands of the business going forward. Of course, our first priority is to ensure the safety and soundness of the balance sheet through the current environment, which remains somewhat volatile. When we emerge from this challenging credit cycle, we expect to be well positioned for significant share and debt repurchase as well as investments in customer experience over time. These will all be made possible by the continued strong cash flow generation of the core business.

With the additional provision in the quarter, net of charge offs, allowance for loan losses increased to $209 million, representing a 76% coverage of total non-performing loans. To put this number into context, we look at coverage levels by asset class breaking them down across firstly mortgage, home equity, and consumer loans. In the spirit of transparency, we have provided additional tables in our press release detailing loan balances, performance metrics and credit ratios by asset class.

Our ending allowance to non-performing loan ratio of 76% includes 8% coverage on first-lien non-performing loans, 116% coverage on home equity loans, and over 330% coverage on consumer loans. Net interest spread in the quarter dipped by 6 basis points which was a combination of a 12 basis point increase in funding costs, partially offset by a 6 basis point increase in asset yields. Given the timing of the Fed cut, the quarter only had a 2-week benefit from lower rates, and we expect to see a more meaningful benefit to overall funding costs in the upcoming quarters.

With respect to our earnings guidance for the remainder of the year, we are revising our outlook primarily due to the securities impairments recorded this quarter. As a base line forecast for the business, we are projecting earnings of $0.85 to $0.90 per share. This range includes assumptions that provision expense in Q4 will be approximately $80 million with no additional securities impairments. We believe that in this environment it is extremely difficult to forecast credit-related items.

As a result, we believe it is prudent to include another $0.10 of downside to this forecast against the possibility of further credit deterioration in some combination of impairment and provision for new 2007 full year guidance of $0.75 to $0.90. This implies fourth quarter earnings of between $0.13 and $0.28 per share given the year-to-date earnings of $0.62.

In conclusion, the third quarter was a tough and frustrating one for the Company with two distinctly different story lines. On one hand, the retail segment experienced tremendous success with growth and record results throughout the business. On the other hand, the challenges we and the broader financial industry are facing as a result of the stress in the housing market, completely overshadowed the success of the retail business. As we navigate through the continued dislocation in the credit market, we will continue to make disciplined and often difficult decisions to manage through this strategic transition and focus on the true value of the franchise.

This concludes our prepared remarks. Operator, we are now ready for questions.
QUESTION AND ANSWER SECTION

Operator: Thank you. Our first question is coming from Rich Repetto of Sandler O’Neill. Please go ahead.

<Q – Richard Repetto>: Yes, good evening, Mitch.


<Q – Richard Repetto>: I guess the question has to do with the ABS portfolio and the 197 impairment. I guess I’m just trying to understand, how were they performing? I know you sold them at $0.50 on the dollar. I know that wasn’t the plan. I know you want to accelerate the transition and get out of this situation as quick as you can. But I’m just trying to see -- that CDOs and second liens is over 600 million from the last disclosure. I’m just trying to get more color on the background on the write-down.

<A – Mitchell Caplan>: Okay, happy to do it. So, first of all, let me be clear, we did not sell them. Okay? So this loss is an unrealized loss, it’s an impairment running through the P&L, the sale that we did not actually sell the securities. If you remember when we last spoke and when we were on the road, we were specifically circling up as an area of concern with respect to our overall securities portfolio -- the ABS. We felt extremely comfortable obviously with our triple As, in our agency, and so, what we really looked at in particular, against the entire backdrop of the 3 billion in ABS CDOs -- I mean in the asset-backed securities portfolio, was the CDO composition as well the second lien composition. And what we have done is, as you know, the market’s fluid, it’s challenging; it keeps moving. We’re constantly in a position where we’re re-evaluating and refining the forecast. When you looked at that and we came back, we made the determination, right, that we needed obviously to have certain write-downs, but more importantly, that we did not want to continue to hold these securities to recovery. And so, as a result of designating them or changing our intent as a management team given all these other facts and circumstances I just described, it doesn’t matter whether the securities are cash flowing, what happens is you impair them at that point at market value. So what we did in working with DNT and our team internally is if there’s a mark that’s readily available, you use it. If there’s not a mark that’s readily available, you use market valuation. And so Rob spoke to was that, across the board they were marked to less than $0.50 on the dollar, and that is across both the CDOs and the second liens. There’s a specific breakdown for each of them. Rob, do you remember?

<A – Robert Simmons>: Well, specifically the ABS portfolio and the second lien were marked through the A tranche to, in the case of CDOs, about $0.53 and about $0.28 on the second liens.

<A – Mitchell Caplan>: Perfect. So fundamentally, Rich, as a result of recognizing the fluidity of the market, recognizing that we were going to be in a place where we were going to see these charge-ups starting to come through, and that we did have the flexibility as a management team to make the decision to no longer hold these to recovery, it allowed us to move the impairment forward effectively to the benefit of future quarters.

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

<Q – Michael Vinciquerra>: Thank you. Good afternoon. Just to clarify that, Mitch, just wanted to make sure. So you haven’t sold them but you intend to sell them? Or have you sold them since the end of the quarter? I’m not quite clear on it.

<A – Mitchell Caplan>: Okay, perfect question. We have not yet sold them. I think one of the things that we have talked about very clearly over and over again is the success that we are experiencing in the retail franchise, the engagement we’re seeing with our customer, the
importance of showing the strength of our business model whether it’s through the engagement of the customers, our capital ratios, our excess liquidity provisions -- protection as well as where we are in terms of overall capital. So, recognizing that, we understood that one of the things that was imperative, and we talked about on the last call, was this transformation from the balance sheet, as it currently stands, to one that is really almost exclusively driven by retail. Getting to an 80 or 85% retail balance sheet both on the asset and liability side. There a number of ways to do that. Obviously one is to de-lever so, if you have prepayments just to allow the balance sheet to shrink, particularly with your securities. Another would be to sell them. So given what we were seeing in the marketplace, our view was that we no longer wanted to hold these securities in the ABS portfolio around CDO and second lien to maturity given that there would clearly be write-downs. And so, we believed that the best thing to do was to change our intent to hold them through recovery, designate them as no longer held for recovery. The accounting impact of that is an immediate impairment. We talked about the impairment and that's how they are currently marked. We will take advantage as the market firms of selling them and if we could sell them in the ranges that they're marked at it is certainly an opportunity that we would take advantage of to help speed up this transformation. One of the things we as a management team realize is that the incredible success that we're seeing in retail is being overshadowed by this very volatile and uncertain credit market and the faster that we can make that transformation, the more important it is for us.

<Q – Michael Vinciquerra>: Okay, thank you. And following up a little bit, when you guys were on the road recently, you were talking about if you had to mark your entire ABS portfolio to market, I think you were saying $400 to 450 million seemed like a reasonable mark if you went ahead and sold everything today. Can you update us as to where that might have stood at September 30 when you did your analysis?

<A – Mitchell Caplan>: I'm happy to do it. So, the current mark on the entire ABS portfolio today, negative mark, would be $268 million. Of that 268, 137 relates to below AA and 131 relates to AA and AAA. So, you can see -- as well as the fact the 268 is in fact a pre-tax rather than an after-tax number. So when you think about the breakdown, I guess the risk is really in our minds going forward, around the 137 million that relates to anything below AA in the ABS portfolio on a pre-tax basis. Rob anything you want to add?

<A – Robert Simmons>: No, other than obviously there still is the risk that other rating agency downgrades could move other AA bonds into a category that they would become at risk. But again, it’s very difficult to forecast this market. And so, as we look at the current mark of the ABS book as Mitch mentioned at 268 million with roughly half of that being AA or higher, we feel like we’re -- that we’re in a reasonably good place this quarter.

Operator: Thank you. Our next question is coming from Matt Snowling of FBR Capital Markets. Please go ahead.

<Q – Matt Snowling>: Yes, hi. Can you give us a little bit better explanation as to what happened to the OCI account?

<A – Mitchell Caplan>: To the OCI? Absolutely.

<Q – Matt Snowling>: Yes, there’s was $144 million drop, to summarize?

<A – Mitchell Caplan>: Yes. Rob, do you want to...

<A – Robert Simmons>: Sure. So, ending OCI this quarter was about $483 million as you can see on the balance sheet there. Just to give you a quick kind of sense of the composition of that, if you think of it, and obviously that’s on an after-tax basis, so all these numbers that I’ll talk about will be comparable on an after-tax basis. The MBS component of it, the agency that -- the AAA component of the 483, is about $315 million of that. So, roughly 62% of the OCI balance you see
relates to our MBS portfolio, the $268 million that relates to the ABS portfolio that Mitch just went through, on an after-tax basis that would represent about a 169 million of that 483 balance. So, and again, half of that would relate to securities that are AA and above. So, you can see the vast majority of the mark in OCI relates to a combination of MBS agency paper and ABS that’s AA or higher rated.

<Q – Matt Snowling>: And for 315 from the MBS portfolio, I would have thought that would have gone the other way given where -- rates coming down, or is that just spreads widening?


<Q – Matt Snowling>: Okay.

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

<Q – Roger Freeman>: Hey, good evening.

<A – Mitchell Caplan>: Hey, Roger.

<Q – Roger Freeman>: I guess the thing that struck me in just looking at the supplemental disclosures is it looks like there was another 15% deterioration in the delinquencies in the HELOC portfolio from August to September? It went from 349 to 404? And it looks like the 80 to 90% CLTV tranche there actually had the highest increase? I guess, Mitch, can you talk a little bit to that and just put that in the context of the 25% incremental deterioration you were expecting this year and plus another 25% next year? Just the trend line doesn’t look to encouraging.

<A – Mitchell Caplan>: Happy to do it. So, as you see the increase there, remember when we were on the road we were talking about two things affecting the overall value. One would be a 25% increase off of August by the end of this year and then an additional 25% next year. And the other thing we talked about is seeing the recovery values drop from 85 to about -- well, in our model, 80 to 70 by the end of the year, although we were currently running at 85. As you look at the increase [audio gap] 90 to 100, so the areas that while we were on the road and the last time that we did the call that we circled up. I think we are still comfortable by and large with the range of about 25% growth rate given that we are continuing to see recovery rates pretty consistent at about 85%. So it may be a little higher on one and a little lower on the other. As you go into next year, again, we believe there will -- and we’re still of the belief there will be another drop from 70 to 60 and another increase of 25%. I think the most important take-away, however, is that if you noticed in the guidance that Rob just gave, he talked about the base business and what he thought it would earn, and then he said we are, in an effort to be prudent, considering another $0.10 of possible credit deterioration which could come from either securities impairments or some of these trend lines that you have seen, notwithstanding the fact that what we’re currently seeing, I think we’re reasonably comfortable with what we have said. But again, it’s a market in flux, and that was the identification of the additional 10 million -- I mean, $0.10 or $65 million.

<Q – Roger Freeman>: Okay. That’s helpful.

<A – Mitchell Caplan>: That help?

<Q – Roger Freeman>: Yeah, that helps. I guess my follow-up...

<A – Mitchell Caplan>: All of that is -- and all of that by the way is pre-tax.

<Q – Roger Freeman>: Right. Okay. And then my follow-up is then back on the CDOs. Again, it looks like you marked-down the ABS CDOs, according to the supplemental disclosures, just about
$100 million. And as you point out, it’s all in the below AA category. But then, Mitch, you also said that the mark on that would be like 137 million. So can you reconcile that difference? It looks like it didn’t -- it’s not fully marked to where you could sell the stuff at. Is that a fair assessment?

<A – Robert Simmons>: Let me clarify. When you’re talking about the mark on the ABS portfolio of $268 million, about half of that relates to AA or above. So about half of that obviously is in that A or below category. The marks that we took, specifically to the ABS CDO book and the second lien book, were the marks we talked about earlier where we marked them, you know, not to zero, but we marked, for instance the ABS CDO book to about $0.53 on the dollar and the second lien book to about $0.28 on the dollar.

<Q – Roger Freeman>: Thank you.

Operator: Our next question is coming from Matthew Fischer of Deutsche Bank. Please go ahead.

<Q – Matthew Fischer>: Hi, good evening.


<Q – Matthew Fischer>: The -- first off, the Tier 1 capital, again, you mentioned, you know, it dipped below 6%. But you I guess want to improve that, keep that up above 6%. So what’s the comfort level here? And how will this impact your buybacks?

<A – Mitchell Caplan>: It’s a great question. We ended Tier 1 at 5.88. As Rob said, we ended risk based at 10.5 bps, assuming that directionally we’re going to move up 6%, 11%, whatever. First of all, one clear possibility is in Q4 if we allowed the prepayments to roll through and the balance sheet to de-lever, that would move you directionally where you want it to go and we certainly mentioned that as a possibility as we work through Q4. At the same time, I think it’s important to note that we have, on a pre-tax basis, corporate cash that we could downstream in excess of $258 million that is totally available to be down-streamed if that’s what we wanted to do. As well, we have an undrawn line of credit on a pre-tax basis that’s about $396 million.

<A – Robert Simmons>: Let me just clarify. There’s about 160 million of cash at corporate with again, as Mitch mentioned, 250 million of a completely undrawn revolver. Now those are obviously -- they would be available effectively on an after tax basis to cover higher pre-tax losses if necessary.

<A – Mitch Caplan>: Right that’s exactly correct.

<A – Robert Simmons>: Sorry.

<A – Mitch Caplan>: And so as we look at that we see the opportunity for us to be able to increase our capital ratios. I think as Rob said, the most important thing for us is to solidify our capital position given the uncertainty in the market and then once we get beyond that, as Rob I think also said in his comment, it puts us in a position given our strong cash flow to begin a share and debt repurchase program.

<Q – Matthew Fischer>: Okay and for your next question, home equity loans roughly flat from 2Q. How quickly and how will you go about the planned mix shift toward first lien?

<A – Mitchell Caplan>: It’s a great question. So, there are two possible ways. The first is obviously you are going to have continued prepayments in your loans, both in your firsts and your seconds. As the prepayments come through, we certainly will not be replacing them. So that will
be one way that you begin the mix shift. And the other would be to the extent we made a decision over time to either sell them or securitize and sell them, which would also expedite the mix shift.

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

<Q – Howard Chen>: Hi everyone.

<A – Mitch Caplan>: Hey Howard.

<Q – Howard Chen>: Hi Mitch. First question, I guess is a bigger one. It’s been a month since you announced this strategic realignment. You as the management team have had time to access the situation, take two cuts of the numbers and see your shareholders and incremental owners. So, I guess, realizing that it’s a changing environment, I’m just curious, what lessons do you and the management team take away from the past few months? What in management’s control doesn’t happen again going forward?

<A – Mitch Caplan>: I think we have — I have come away with a couple realizations most of which I think, I hope, I believe very strongly that I knew going into it. One, and that is the customer is at the center and the most important of everything we do. And so, as we think about the decisions we make in running our business, it is all about continuing to ensure for that customer, both a great value proposition, with respect to product and services and also making it clear to that customer what a solid, stable and growing franchise we have by discussing things like excess liquidity. I think it’s up to now 14.4 billion from the FHLB has actually increased, continuing to de-leverage the balance sheet, strengthening our capital ratios and obviously the sources that are available for us for additional capital. So, I think that’s the first thing we learned. The second thing that we learned in the process is, it is absolutely imperative to have a phenomenal management team. And I will tell you I think I am incredibly blessed. The team has been extraordinary in working together in what has been a very, very difficult time. Without a doubt, on the retail side, the whole team stayed focused and delivered results that I think are incredibly impressive, summer or otherwise. And with respect to looking at what’s happening in the marketplace from the, I guess the instability and the fluidity and the challenging environment, we are dealing with exactly the same thing that everybody else is dealing with. And so, as a result of that, it’s all about having a strong team that can evaluate and make decisions that are appropriate, I think promptly, and then execute as quickly as possible.

<Q – Howard Chen>: Okay, thanks and then a quick follow up on the numbers. Rob, you mentioned in your prepared remarks you expect to see some benefit from the recent Fed cut in upcoming quarters but I guess earlier this week I saw you cut the max savings yield by 25 bps to 470 following a 50 bp rate cut so, I guess, can you discuss what impact that may have on the net interest rate going forward? And what helps alleviate that spread compression? I know management in the past has spoken to not wanting to have a top 3 yielding savings product but at 470 I think you’re kind of there so has there been a change in deposit pricing philosophy?

<A – Robert Simmons>: Let me talk a little bit about spread and then I’ll let Jarrett talk about pricing because I think it is a very important part of our strategy. With respect to spread, obviously, one of the things that we have been talking about for the last month is strategically moving towards a place where in a balance sheet that’s much more retail-centric has less wholesales funding, in an environment where we continue to grow cash that we think that over time that will have a nice, positive impact on spread. Again, we were very pleased to see, even in a seasonal quarter with obviously the summer months but also the volatility that we saw this quarter in the market that we were still able to grow our cash by 1.6, $1.7 billion I think was a real accomplishment and I think that it’s part of our strategy going forward is to continue to accelerate that balance sheet transition that we’ve been talking about. Reduce the wholesale components of it which over time will have the effect of widening spreads.
<A – R. Jarrett Lilien>: And I think Howard, where you’re right as well is that there are forces there that will help increase spreads such as growing customer cash and replacing wholesale borrowings. But on the other hand, there are other forces that are contracting on spread. As rates come down on some of our lower rate products, there’s only so far that you can go down and so you won’t be able to pass every Fed rate cut through the market. With our highest grade products, one of the things that we have to be very conscious of is really stability with the customer and fulfilling the promises we make to the customer and so we are looking at being able to manage any rate changes in a sort of measured way and if you look at the markets I think what there’s something like 70% probability of another 50 basis point cut in the market, something like that right now. We’ve got a weigh our rate cuts and not be all-over-the-board. So, we’re taking those in a measured approach, 470 looked like the right place to be for now. If there is further fed action, or even if there isn’t, we may bring our rates down but some of it is fed related, some of it is the competitive environment. We don’t want to be tops but we want to have an attractive savings product.

<A – Mitchell Caplan>: And you only, a couple points I’d add is that one of the things I look at is that not only were we successful I think at bringing in 1.7 billion but we brought it in flat to the prior quarter on an incremental cost I think of 3.9. So our incremental cost of funds was 3.9% again in the quarter. Given that, as we’ve always said, the vast majority of what we’re bringing in is coming from an investing customer. They are traditionally opening both a free creditor sweep account and at the same time this other account. I don’t believe we have changed our philosophy of wanting to be one of the top rate providers, I don’t think we will ever. I think we’ve always basically been comfortable with being in the top 20 or 25 and so what we’re working through now as Jarrett said is what’s the long-term strategy as the Fed continues to act?

And then the other thing I’d say is, when you think about spread again, absolutely it is a balancing act. So the good news is you will replace wholesale funds, which are clearly more expensive than cash under any circumstances, particularly when you think about the cost of adding the hedge to extend out the duration, and so there is a value in that. And certainly as long as we can continue to bring in at a 3.9% incremental cost of funds, I’m pleased there. When you move over and you look at the asset side, without a doubt, you will have compression as a result of things that are generating a higher yield like your second liens coming off and being replaced with first liens. But at the same time you will have a benefit of securities coming off, which typically have the lowest yields. So net net I believe over time, you will see spread widening as a result of the balancing of all of these different acts.

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

<Q – Prashant Bhatia>: Hi.

<A – Mitchell Caplan>: Hey, Prashant.

<Q – Prashant Bhatia>: Just on the home equity, the 146 basis points of charge-offs. I guess where is that now and according to your models, where does that peak?

<A – Mitchell Caplan>: Where does that peak now?

<A – Robert Simmons>: In Q1 of next year we expect it to increase [inaudible] Q1 by about 25% from current levels.

<A – Mitchell Caplan>: Okay.

<Q – Prashant Bhatia>: Is that expected to be the peak in Q1?
<A – Robert Simmons>: It is in our current model.

<A – Mitchell Caplan>: Q1 and I think we expect it to then be flat in Q2 and in Q3. So peak and not decline if I remember correctly until the end of next year.

<Q – Prashant Bhatia>: Okay and just based on that model, how accurate has that model been so far?

<A – Mitchell Caplan>: It’s been basically right in the range.

<Q – Prashant Bhatia>: Okay. And then in terms of the mark-downs that you’ve taken to $0.53 and $0.28 on the dollar, you said still didn’t sell the assets and I guess, why not?

<A – Mitchell Caplan>: Because we made the decision to impair the securities quite recently once we made the decision as a management team given all the facts that I talked about with the fluidity and the changing marketplace and the mark-downs as well as the decision to no longer hold them to recovery to be in a position that once we got there we took the impairment and we are, as you could well imagine working on it.

Operator: Thank you. Our next question is coming from Michael Hecht of Banc of America. Please go ahead.

<Q – Michael Hecht>: Hey guys thanks for taking my question. I guess first question, I just wanted to come back on net interest spread, I mean it sounds like over time there’s going to be a lot of moving parts but hopefully room to go up. But kind of near-term, can we talk a little about where net interest spread I guess kind of ended the quarter versus the 265 kind of average for the period?

<A – Mitchell Caplan>: I’m not sure of where it ended the quarter versus the average to be honest – to be direct.

<Q – Michael Hecht>: Okay. Maybe we can shift a little over to the expense side then, which seemed a bit high particularly kind of comp expense. How should we think about comp expense levels either in dollars or percent of revenues kind of going forward here? Do you guys have any flexibility in the model to offset what looks like some pretty significant negative operating leverage?

<A – Mitchell Caplan>: Let Rob take it.

<A – Robert Simmons>: So, let me -- first of all, comp expense quarter-over-quarter was actually down by about $1.5 million. So, I mean, salaries are down, commissions are down, et cetera. I mean, if you’re looking at it as a percentage of revenue, it’s going to be apples and oranges because the provision and the impairments obviously as you know run through the revenue line item, and so they make a quarter-over-quarter comparisons as a percentage of revenue not meaningful. But quarter-over-quarter comp expense is actually down.

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

<Q – Bill Tanona>: Hey, good evening, guys.

<A – Mitchell Caplan>: Hey, Bill.

<Q – Bill Tanona>: Just a quick one here on the net new asset flows. Obviously third quarter was a record on the retail side of the equation. You guys brought in 1.1 billion versus 1.6 in the prior quarter. Schwab is the only one who’s actually reported those statistics yet. They were up about 40% where you guys are down about 30%. So I’m wondering what type of ramifications, if any, all
the negative news or headlines is having in terms of the retail investors’ willingness to put money with you guys.

<A – R. Jarrett Lilien>: Well, actually we’re not really seeing any real impact there. I guess big picture, I think in August there was some impact. I mean, we had customers that were calling, that were concerned. They were wondering about capital levels, security of assets, and that’s where I said in the prepared remarks that we spent a lot of time communicating with our customers. But what we’ve seen I think were some very encouraging things with our customer behaviors. First of all was seeing that they were actually net buyers in the quarter. So they were putting more money into the market and they were also out there putting more cash into their accounts. And again, there were numerous rumors out there in August, and even in spite of all of that, you had net buying; you had increases in cash; and basically a very positive customer experience, starting really with account growth, which we also saw which has been something that’s been very positive and where it counts, in the target segment.

<Q – Bill Tanona>: And I guess if you think about that from a monthly standpoint, have you seen a difference in -- did you see a difference in the trends throughout the quarter? And if so, how has that continued into the early part of October here?

<A – Mitchell Caplan>: We really don’t comment so much on past September 30. But one thing I will say about the health of the customer is that they were very strong net buyers in August which obviously with hindsight proved to be a smart thing. And they were pretty good net sellers in September, so they made money. If you look at leverage ratios, obviously margin was up but margin as a percentage of investing assets quarter-on-quarter was actually down. So less leverage, buying appropriately, selling appropriately, bringing in more cash. Also in terms of what they were trading, we actually saw bulletin board volume down quarter on quarter, which given that volumes were up so much, that’s pretty interesting. So, where we saw our customers transacting was less in penny stocks and more in NASDAQ and New York listed stocks. And again we saw options as a percentage of total DARTs up to record levels, which is again a positive indication as they’re using those to hedge and yield enhance. So, a very positive sort of quarter for the customers showing that they’re healthy, which gives me confidence. A healthy customer means that they’ll be back again and that gives me some confidence that this can continue for a while.

<A – Mitchell Caplan>: And the only thing I think I would add to that is there is no doubt that there was an impact. The good news is that at the end of the day the TOAs in were significantly greater than the TOAs out and we were able to see all of the metrics you’re seeing. But if you look at a year-over-year comparison, we were growing at about 24% in our segment. It’s slowed to 16%. I think some of that is the seasonality and I think some of it is the attrition that we did see pick up in the month of August around all of the rumors. And so to answer your question specifically, I think we saw August be much lower and September begin to resume to more normal levels with respect to asset inflows.

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

<Q – Michael Carrier>: Hi, guys.

<A – Mitchell Caplan>: Hi, Mike.

<Q – Michael Carrier>: Just a follow up on account growth. It looks like your overall account growth is decent in the quarter and then target growth was good. But it seems like almost all the growth was in the banking area, quarter-over-quarter, and year-over-year. I’m just curious kind of what’s going on under the covers with the brokerage account growth?

<A – Mitchell Caplan>: I think the most important thing -- let me turn it over to Jarrett, but again, I think I say this every quarter and I’m not sure that people really recognize it, it’s the same
customer. So when you see an account grow, you’re actually seeing a customer grow. And it may not be necessarily one-for-one because some of it is as you know the plan is around acquisition, migration and retention. And so, the vast majority of our balances and the vast majority of our accounts when you look at banking and lending are in fact coming from your investing and trading customers.

<A – R. Jarrett Lilien>: And then in terms of overall accounts it was actually a strong quarter any way you slice it. I mean in terms of brokerage or bank, still better on a gross account basis than any quarter of all of last year. And then you look at it a couple of ways. I mean marketing spend was down 26% quarter-on-quarter but gross accounts were down 13% quarter-on-quarter. And I’d rather look at it the other way which is summer-to-summer, so a year ago to this year we actually spent 11% more on marketing and saw gross account growth of 13% more. So any way you really want to come at this thing, this was a great summer for new accounts in both brokerage and bank, and then Mitch’s point’s right on target, the people that are opening bank accounts are the brokerage customers.

<A – Robert Simmons>: Yes, if you look at the -- this is a trend that has been going on for several quarters where, if you look at the significant cash that we’ve been generating as a firm, it has been -- we’ve been generating cash to -- primarily to brokerage customers. Either a customer who is a new brokerage customer in the quarter that also is opening some sort of a deposit account or an existing retail brokerage customer that’s adding to an existing account or opening another account. We’ve been running upwards of 70 to 80% of our cash increase that we’ve been seeing over the last several quarters has actually been cash from brokerage customers.

<Q – Michael Carrier>: Right, okay. That makes sense. I think I’m just kind of looking at it more on the economics, meaning if you have a lot of the accounts going on the banking side it just -- the deposit rate’s going up and the losses, on the assets, going down, except we saw more growth on the brokerage side.

<A – Mitchell Caplan>: No, it’s actually a great question because, to my earlier point, you actually are not seeing cost of funds go up. They’re staying pretty flat at about 3.9%. That’s the first point. And the second, is that, and I think we mentioned this in the call, but, we should probably continue to point out more and more so people understand it, when you look at a customer who opens a cash account, they also increase their assets with us. They also increase their trading behavior. They also increase their margin balances. So generally, cash is a leading indicator of a deeper engagement. It’s usually the first thing that comes after the brokerage account is opened, and then you begin to see increased balances across margin trading and cash and assets in a way in which it all drives to the bottom line.

Operator: Thank you. Our next question is coming from Rich Repetto of Sandler O’Neill. Please go ahead.

<Q – Richard Repetto>: Yes, hey Mitch. Just a follow-up. On the -- I wasn’t clear on the buyback whether you can -- whether that was being delayed or can you start buying back shares with free cash or whether you were going to concentrate on the capital ratios?

<A – Mitchell Caplan>: I think the first thing we’re going to do is concentrate on the capital ratios and make sure that, from our perspective as a management team, everything is absolutely as sound as we want it to be. Remember, the customer matters first and foremost. And then once we are at a comfortable level, whether it’s down-streaming from corporate, whether it is additional retained earnings, whether it’s de-leverage, whether it’s drawing on a line, whatever it may be, and we feel comfortable, then we will begin the process of repurchase of shares.

<Q – Richard Repetto>: So it’s probably a ‘08 event now?
<A – Mitchell Caplan>: I would say so.


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

<Q – Michael Vinciquerra>: Thank you. If I could ask a couple questions, just on the trading side. The institutional business in your original release with the credit side of things, you mentioned that you were restructuring that and I was under the impression that it was going to shrink, in terms of its commission generation, going forward. Can you talk about the timing there and if I read that correctly?

<A – R. Jarrett Lilien>: I guess you did read that correctly, but what we’ll be restructuring are some of the non-US institutional pieces and we’re making progress but that’ll be finalized towards the end of the year so the real impact that you’re going to see is into 2008.

<Q – Michael Vinciquerra>: So the $46 million in institutional commissions this quarter, is that expected to drop? Notwithstanding the nice up-tick in volume we saw this quarter but is that expected to be off noticeably as you restructure that business?

<A – R. Jarrett Lilien>: Into 2008, we’ll talk about that when we give guidance but there will be pieces of that business that will no longer be with us.

<A – Mitchell Caplan>: That’s correct. The only thing I would say is, if you break it up right now, I think the US is a much more significant percentage of what is driven than internationally and so there will be an impact but it should be diminutive when you think about it within the context of the overall P&L.

<A – R. Jarrett Lilien>: Yes, I mean if you think about it we’re restructuring the parts that weren’t that profitable.

Operator: Thank you. I’ll now turn the call over to Mr. Caplan for any closing remarks.

Mitchell Caplan, Chief Executive Officer

I thank you all for joining us on today’s call. Clearly, I think as everybody knows, it’s been a pretty tough period macro-economically and for the Company given all these credit challenges but we’re very pleased with the success that we’re seeing in our core retail business. We obviously will continue to execute on our strategic plan in order to manage through this very volatile credit situation and focus the company on the opportunity and the strength of the franchise that we’re building. So thanks again and everyone have a great evening.

Operator: Thank you. This concludes today’s conference. You may now disconnect.