MANAGEMENT DISCUSSION SECTION

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

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

Susan Hickey, Investor Relations

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

Before turning the call over to Steve, I would like to remind everyone that during this conference call, the company will be sharing with you certain projections and other forward-looking statements regarding future events or its performance. E*TRADE Financial cautions you that certain factors, including risks and uncertainties referred to in the 10-Ks, 10-Qs and other documents E*TRADE files with the Securities and Exchange Commission could cause the company's actual results to differ materially from those indicated by its projections or forward-looking statements. This call will present information as of July 22, 2010. Please note that E*TRADE Financial disclaims any duty to update any forward-looking statements made in this presentation.

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

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

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

Steven J. Freiberg, Chief Executive Officer

Thank you, everyone, for joining us this afternoon. To begin today's call I will share a number of highlights from the recent quarter and then I will turn the call over to Bruce to take you through the quarterly results. After I add a few closing thoughts, we'll be happy to take your questions.

The second quarter marked an important milestone for E*TRADE as we recorded our first quarterly profit in three years. We reported net income of $35 million on net revenue of 534 million, reflecting terrific progress from a year ago when we reported $143 million loss on net revenue of 621 million. Our results are a testament to the contributions of thousands of E*TRADE employees and to the loyalty of millions of E*TRADE customers and they were certainly a nice welcome for me in my first full quarter as E*TRADE's CEO.

Our profitability in the quarter was driven by several items. First, we had solid performance in our brokerage business which strengthened new assets and growth in a number of key metrics including DARTs, new accounts and margin receivables. Second, we benefited from the ongoing improvement in loan performance trends resulting in a substantial decline in our loan loss provision.

Third, we prudently managed our expenses. Finally, effective balance sheet strategies resulted in solid net interest income in an environment of declining interest rates as well as opportunistic gains on loans and securities.

With this quarter's results, we have now achieved three important milestones that support our return to sustainable profitability. First, our provisions for loan losses are now consistently below charge-offs having reached that inflection point in the third quarter of 2009. Second, we are now generating organic bank regulatory capital, continuing the trend that began in the first quarter of this year. And third, this quarter marks our first profitable quarter since the second quarter of 2007.

I am particularly pleased with results of our work to reduce the balance sheet and mitigate risk. In addition to the decline related to prepayments and scheduled principal reductions, we securitized or sold 232 million in loans. And our continued effort to put back loans to sellers resulted in a $20 million legal settlement of loan claims, which contributed 15 million to the reduction in this quarter's provision and charge-offs. These actions, supported by improving delinquency trends, drove a meaningful reduction in balance sheet risk.

While we are proud of our results, we know there is much work ahead to ensure we sustain and build on our momentum. We are gratified, though, that our financial progress provides us with increased flexibility to invest in the products, services, and technologies that will enhance our customer franchise to better realize growth opportunities that should drive shareholder value. During the second quarter, I spent time with employees in a series of town hall events and in smaller meetings with our management teams. I was energized by their engagement and their commitment to enhancing the customer experience through innovation and service.

We have recently demonstrated this commitment in a number of areas, including the April launch of E*TRADE Mobile Pro for iPad, continuing our leadership in the rapidly growing mobile space; the release of open application programming interface or API, allowing third-party vendors and independent software developers to interface seamlessly with our investing platform; growth in our relationship management team to enhance the customer sales and service experience; and the elimination of our remaining account service fees to support our transparent pricing philosophy. This helped drive a 230 basis point sequential improvement in our customer attrition rate from 15% to 13% as we move closer to our objective of 10%.

When we spoke last quarter, I was just a few weeks in with E*TRADE but already optimistic about the opportunities. Since then my initial optimism has been reinforced. I have been very encouraged with the caliber of employees throughout E*TRADE. They have been through a challenging period as they continue to innovate, they are engaged and most importantly, they are focused on winning.

In addition, our financial progress, as I said, provides us with increased flexibility not only to reinvest in the business but also to develop the appropriate plans to enhance shareholder value. I look forward to our ongoing dialogue as we build on our momentum.

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

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

Thank you, Steve. Clearly, we are extremely pleased with our quarterly performance, which was supported by strength in our brokerage business, positive trends in our loan portfolio and effective balance sheet management. We reported net income of 35 million or $0.12 per share during the second quarter, which compares with a net loss of 48 million or $0.25 per share in the prior quarter and a loss of 143 million or $2.16 per share in the second quarter of 2009.

During the quarter, we generated 534 million of net revenue, a decline of 3 million from the prior quarter and down 87 million or 14% from the same quarter a year ago. Our revenue this quarter included net interest income of 302 million, which was down 18 million compared with last quarter. This 6% sequential decline reflected a 1.4 billion decline in average interest earning assets to 41 billion and a 7 basis point decline in net interest spread to 2.89%. This reflects our strategy of maintaining a relatively consistent net interest spread despite an environment of declining interest rates.

Commissions fees and service charges, principal transactions and other revenue in the second quarter were 195 million and this was essentially flat compared with the prior quarter as an increase in DARTs was offset by a $0.33 decline in average commission per trade from $11.38 to $11.05. This decline reflected the pricing changes that we implemented earlier this year as well as customer mix.

We again experienced increased principal transactions in our market making business, which we see as a continued growth opportunity. This business generated 29 million in revenue, which represents an increase of 10% from the prior quarter and 26% from the prior year.

Our revenue this quarter also included 37 million of net gains on loans and securities including a net impairment of 12 million as we managed our investment portfolio to limit our risk and realize gains due to favorable market conditions.

Our total operating expense for the second quarter declined 7% or 20 million from the prior quarter to 276 million. This included lower compensation, advertising, and restructuring costs. Our operating expense also declined by 16% from the second quarter of 2009, and by 10% if we exclude the one-time FDIC assessment of 22 million in last year's expenses. We are pleased with this performance, which reflects our ongoing focus on expense management.

DARTs for our U.S. operations were 170,000 during the second quarter, up 10% from the prior quarter, but down 16% compared with the second quarter of 2009, which was a period of significant market volatility. Net new brokerage accounts were 18,000, representing a marked improvement from last quarter's results when we added 2,000 accounts. Moreover, brokerage accounts were up by 21,000, if not for the reduction of 3,000 cross-border accounts in connection with our European restructuring.

Net new asset flows into our U.S. brokerage business were a positive 2.1 billion during the quarter, and now total 4.3 billion year-to-date. Brokerage customer cash declined by 1.1 billion to 20.7 billion, while customers were net buyers of 3.4 billion in securities. Bank customer cash declined by 1.2 billion. Customer margin receivables in the U.S. grew by 26% during the quarter and ended at 4.8 billion. This represented a 60% increase from a year ago.

As Steve highlighted earlier, we are pleased with the performance in our loan portfolio. The portfolio contracted by 1.2 billion during the quarter, including 232 million in loan securitizations or sales, and 746 million related to loan prepayments or scheduled principal reductions.

Our loan loss provision declined from 268 million in the first quarter to 166 million in the second quarter. This is the seventh consecutive quarterly decline in the provision, which is now 68% below its peak of 518 million in the third quarter of 2008.

Equally important, loan charge-offs declined from 288 million in the first quarter to 225 million in the second quarter. This is the fourth consecutive quarterly decline and charge-offs are now 42% below their peak of 386 million in the second quarter of 2009.

The decline in the loan loss provision and charge-offs this quarter included the benefit of a legal settlement on loan claims, as we continue to look for opportunities to put back loans to sellers. The

$20 million settlement contributed 15 million to the declines during the second quarter, and we expect the remaining five million to reduce our provision and charge-offs in the third and fourth quarters.

The allowance for loan losses ended the quarter at 1.1 billion, down 59 million from the prior quarter and remains at 6% of gross loans receivable. The improvement in our loan loss provision and loan charge-offs was driven primarily by our improving delinquency trends.

Total special mention delinquencies declined by 14% with a decline in the one-to-four family portfolio of 17% and a decline in the home equity portfolio of 8%. Total special mention delinquencies are now down 36% from their peak in the fourth quarter of 2008.

Overall, we were extremely pleased with the improved credit performance and expect that credit costs will continue to decline. However, because the timing and magnitude of the improvement is affected by many factors, we anticipate variability in any one quarter while continuing to see a downward trend over the long term.

We are pleased that the bank generated capital again this quarter. The bank generated 61 million in regulatory risk-based capital during the quarter, bringing the year-to-date total to 108 million. Our bank capital ratios continue to be substantially in excess of regulatory well-capitalized thresholds.

As of June 30, the Tier 1 capital ratio was 7.27% to total adjusted assets and 13.39% to risk-weighted assets. We ended the quarter with one billion of risk-based total capital in excess of the level that our regulators define as well-capitalized.

We also are very pleased to report that we generated substantial capital on a consolidated basis during the quarter. We increased consolidated Tier 1 capital from 1.1 to 1.5 billion and we increased our tangible common equity from 1.7 to 2.1 billion.

We ended the quarter with 481 million in corporate cash. This is an increase of approximately 63 million from the prior quarter and included a 100 million refund on the tax loss carry-back legislation, a 25 million dividend from the bank and a 58 million cash payment of the May coupon on our Springing Lien Notes. To summarize, we were very pleased with our performance in the quarter and look forward to building on our momentum.

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

Steven J. Freiberg, Chief Executive Officer

Thank you, Bruce. Before opening the call for questions, let me share a few additional comments. First I would like to comment on the financial regulatory reform legislation that was signed into law yesterday. While this legislation is generally considered to be comprehensive for the financial service industry as a whole, we believe the majority of the changes will have no material impact on our business.

The implementation of holding company capital requirements, however, is relevant to us as the parent company is not currently subject to capital requirements. With that said, we fully expect that our holding company capital ratios will exceed the well-capitalized minimums well in advance of the requirements. Our confidence in our ability to meet these requirements is reinforced by a few items.

First, our trajectory towards sustainable profitability as demonstrated in our second quarter results. Second, anticipated additional conversions of our convertible debt. And third, the utilization of our deferred tax asset as we deliver profitable results. Therefore, I want to emphasize that at this time we are quite comfortable in our ability to meet these future holding company capital requirements, and we have no plans to raise additional capital as a result of the financial regulatory reform.

Finally, we had a very productive quarter on all fronts with organic capital generation, improving trends in the loan portfolio, and now a return to profitability, we are on the right track to enhance shareholder value and I'm fully committed to this most important objective.

I look forward to the coming months as we develop and execute plans for E*TRADE's next stage of growth, and I look forward to engaging with you on our progress with respect to the company's strategy for delivering shareholder value.

With that, operator, we are ready to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Roger Freeman of Barclays Capital.

<Q – Roger Freeman>: Hi, good evening. I guess the first question is, Steve, now that you've been on the job for a quarter, as you think about sort of longer term for the organization, what role do you think a bank has within the E*TRADE product set, the value to customers, products that you want a bank to sell?

<A – Steven Freiberg>: Yeah, that's a relevant question. First and foremost, the role the bank has played in the institution has been important. As I know you're more than familiar, we have approximately $30 billion of customer deposits and those deposits are both pretty important to our customers being an FDIC insured – in an FDIC insured institution. But as important, those are largely and today and probably 70% of those deposits do in fact come from our brokerage customers. They are very low cost, very stable, and very profitable deposits for E*TRADE.

And so that alone really is a compelling reason to have the financial institution, the bank. And I would expect that that will continue over the long-term. In addition to that, we're clearly looking at the bank options and opportunities, but it's a bit premature to go anything that is specific. But again, to just emphasize, very large deposit base, very stable, largely coming from our brokerage clients, very profitable, very important.

<Q – Roger Freeman>: Okay. That's helpful. Then two other questions. One macro around the mortgage portfolio and one a little more granular. I guess looking this quarter again and in prior quarters you've been selling off bits and pieces of the portfolio as opportunities arise.

I mean, I guess looking at the portfolio as a whole at this point, how wide of a gap do you think there is? I imagine you look at this fairly regularly between what you think the value on a mark-to-market basis would be versus what you've accrued to? I mean, I assume that gap continues to shrink?

<A – Steven Freiberg>: I think – I do think you answered the question. Directionally, the differential between book and market is, in fact, improving. That said, I don't really have a specific valuation or number. As you're probably aware that the portfolio really is designated as a portfolio that we will hold, a hold to maturity portfolio, so that our flexibility around the portfolio is relatively speaking extremely limited. But all in all, it's a portfolio that we continue to be aggressive in the management of. I think you've seen in the results, this quarter in particular, we shrunk the portfolio by 1.2 billion, the combination of kind of our normal processes plus the ability to securitize and sell approximately $230 million of assets.

And just to make a point, we sold it actually at a profit so it went out at above par, which we thought was actually a terrific thing to occur particularly in this environment. So we'll continue to manage the portfolio, particularly the legacy book down. But at the same time, I think it would be unrealistic to make any assumption that there would be one large solution to the challenge portfolio.

<Q – Roger Freeman>: By the way, on that point, if given that you're selling loans above par, which I assume is just a function of the low rate environment, the longer rates stay low, those opportunities are more prevalent for you, right?

<A – Steven Freiberg>: I would say that the rate environment is important but again, emphasizing that the portfolio was largely held-to-maturity portfolio.

<Q – Roger Freeman>: Okay.

<A – Steven Freiberg>: And in addition to that, the risk is probably or the perceived to real risk probably the most important element here more so even than the rate environment.

<Q – Roger Freeman>: Okay. And then just one sort of granular question here, looking at your – the stature you're giving on the modifications, the TDRs, when you do that, where typically in the sort of delinquency cycle is that? Can I roughly assume that those are balances that are coming in from the 180-day plus or is it kind of spread out all over? I mean assuming when you do that right, it does come out of your loan portfolio delinquency statistics, right, and becomes a current loan then again.

<A – Robert Burton>: Yeah, this is Bob Burton. The loans do come out of generally the range between 90 and 180 days for the most part. Generally, the first mortgage loans are modified a little bit later in the process. But we've found that we've had good success modifying product even if it's up to the 180-day level. In some cases we've even modified loans beyond 180 days. The performance of that portfolio, the modified portfolio, has been very good. We think we're getting good economic lift. We are going to continue to work that as hard as we can.

<Q – Roger Freeman>: If you do a scheduled principal reduction as part of the modification, then do you take a gain on that to the extent that that reduction is less than what you had basically accrued the loans for on a loss basis?

<A – Robert Burton>: I'm not sure I understand your question, Roger, can you rephrase?

<Q – Roger Freeman>: If you cut someone's principal in a loan mod...

<A – Robert Burton>: Yeah.

<Q – Roger Freeman>: ...do you typically take a gain on that as a result? Because you've already taken charges against that loan that are in excess of what you're agreeing to lower the principal to.

<A – Robert Burton>: First of all, we do very, very few principle reductions. But if we did that it would actually create a loss on the transaction, since we'd write that principal reduction down.

<Q – Roger Freeman>: Okay. All right. Thanks.

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

<Q – Richard Repetto>: Good evening, guys. Hello?

<A – Steven Freiberg>: Hi, Rich.

<Q – Richard Repetto>: Yeah. I guess the first question, Steve, is on expenses. The expenses came down nicely, demonstrated good expense discipline. I understand the advertising. Can you talk a little about the costs coming down when revenues were pretty – just down slightly quarter-to-quarter?

<A – Steven Freiberg>: Yeah. I mean, from the standpoint of compensation, it really had several drivers, Rich. One that really – in many cases preceded my arrival here on the comp side, a fair amount of restructuring on the – particularly on the local international businesses, as well as restructuring in our domestic business, and what we're seeing is the benefit of that now flowing through the P&L. So, A, it's sustainable, in fact, the comp lines from the standpoint of looking out over time should continue to basically follow, I think, a reasonably good trend.

And that's just, again, a testament to getting prioritization into the business, as well as to the hard work that E*TRADE employees have accomplished. It really had three dimensions to it. One is comp, as you pointed out. The second is on a sequential basis, the marketing costs have come down as well. But if you look on a year-on-year basis, we've continued to reinvest at a higher rate in the franchise, meaning marketing costs are actually higher by about 15% on a year-on-year basis.

And then finally, particularly on a sequential basis, the restructuring costs in the second quarter were better than what we basically had in the first quarter. That really makes up, I think, the combination. But just to reemphasize, part of my role is to continue to put a fair amount of pressure on the expense line, but at the same time, not only take expenses where appropriate lower but redirect them both into marketing and sales, as well as product and technology if we can grow the franchise.

<Q – Richard Repetto>: Very helpful. Next question is on the credit reserve. I know Bruce, you talked a little, I thought you've mentioned credit; you expected longer term tending down, but quarter-to-quarter some variance. I'm looking at the reserves and how you build – for example on one-to-four family, the provision equal the charge-offs. And you're carrying allowance that's well above what you'd take as an annual run rate there.

You know if you just take 70 million, it'd be 280. So, I guess the question – and then on home equity, it looks like you play a little catch-up with the modification and release reserves. So my question is, are you expecting one-to-four family deteriorate a bit? Is that why you're carrying such a big allowance going forward? And what type of expectation – are we caught up on the modifications for home equity?

<A – Bruce Nolop>: Yeah. I would say that the factors that go into the provision are really quite a few, but just directionally; the first lien portfolio is further behind the mortgage or the home equity portfolio in terms of vintages and seasoning and modification.

So in a sense, it's still at the point where it hasn't fully crossed the inflection where provision will start being lower than charge-offs. But we expect that to occur in the future. And with respect to home equity, it has achieved that inflection point and modifications are being helpful.

<A – Paul Brandow>: Just one other point – it's Paul Brandow – just want to remind you, Rich, that if you're looking at the total allowance, recall that that's both the general allowance plus the allowance for the TDRs. And the TDR allowance is not an expectation of losses over the 12-month period, it's an expectation of loss over the life of the loan. So the total allowances is not – you can't translate that into a 12-month forward-looking loss estimate.

<Q – Richard Repetto>: Got it, okay. Last question. Looking at the bank average, the interest earned, the average balance sheet at the bank, a couple of the asset classes went up, margin loan, that's great. That's a high margin. But you added a little bit of held to maturity securities, one of the few categories that actually went up as the overall balance sheet went down. Schwab did the same thing at the same yield, the 370 plus yield. So I guess the question is, are there opportunities at a certain duration? And the only other follow-up is on the 232 that you did sell of loans, what type of loans were they?

<A – Bruce Nolop>: Sure. This is Bruce. And we established the held to maturity portfolio for the first time this quarter, so it was something that we instituted. And we added about 800 million of maturities in the portfolio this quarter.

We expect to grow it roughly to be 2 to 3 billion over the next few quarters, and that's where it'll hold. And we did that strategically, because we thought it would be a good match with the customer deposit base that's funding them. So that's the strategy, and we can talk about the individual securities that go in there. But in general, they are agency securities, similar risk characteristics as the rest of the portfolio.

With respect to the securitization and sales of securities of the 232 million, those were conforming securities that we were able to sell and securitize with the Fannie Mae agency. So that was almost a one-off type set of transactions.

<Q – Richard Repetto>: Okay. Congrats, guys. Nice job this quarter.

<A>: Thanks.

Operator: Your next question comes from Daniel Harris of Goldman Sachs.

<Q – Daniel Harris>: Hi, good evening, guys. I was wondering if you could comment a little bit on the rate per trade. Obviously you guys made the change in pricing earlier this year, came down a little bit this quarter. Is this essentially a good rate, or did you see a higher level of certain type of asset trading driven by the volatility in the quarter?

<A – Bruce Nolop>: This is Bruce again. In terms of the impact of the pricing change, the overall impact was about $0.50 to the average commission per trade for the quarter; and sequentially, that was a $0.14 change from the first quarter to the second quarter. So the remaining $0.19 of decline was due to customer mix. And the main factor there was, you had a smaller percentage of so-called Main Street investors who would pay a higher commission. But we also had – just to comment, some offsetting positive mix. For example, options were a good mix this quarter.

<A – Steven Freiberg>: Let me just – this is Steve, I'll just finish up on the commentary. What we talked about for the first quarter when pricing was really implemented, meaning the cost of the business is actually coming in almost precisely on our expectations, so it's also in line with what we expected when we went through the process of both developing both the analytics as well as the strategy prior to execution, so it's actually executing two expectations.

<Q – Daniel Harris>: Okay, thanks. That's helpful. Shifting over to the market making side, this is an area that has continued to show some really nice growth year-over-year. And Knight Capital also noted some pretty positive trends. How should we be thinking about the strength there in the quarter around the flash crash and the volatility there, which probably drove some higher margin trading versus what we should expect going forward? Certainly, it seems like volumes were elevated in the quarter. But was the revenue capture of the margin in that business also elevated?

<A – Bruce Nolop>: You're talking about the market-making, the principal transactions? That was not really a function of the flash crash. In fact, it can be attributed very much to the success in bringing in more external customers. And we think that's one of the benefits by the strengthening capital structure and financial condition of E*TRADE, is it makes us a much more viable and strong competitor in that market. So we see continued growth in that. And again, not related to any of the flash crash issues.

<Q – Daniel Harris>: Okay. And then just lastly for me, the trend we're seeing also, margin that continues to move higher year-over-year across most of the brokers. You guys obviously are benefiting from that, too. Any sensitivity the clients have to a higher margin rate, or how are you thinking about the margin rate here, now that the assets are moving nicely higher over the last 12 months?

<A – Bruce Nolop>: This is Bruce. I would just say that clearly, margin is extremely important to our business. We were very pleased that the average margin balance for us grew by 15% this quarter, which is really helpful to our results. And in terms of the sensitivity of the rate, that is something that we monitor very carefully and we'd want to make sure that we're always competitive, and it's something that we discuss with particularly our major customers to make sure that we're giving them a good value proposition.

<A – Steven Freiberg>: Let me just add one other commentary. I think it's important, even though we grew the margin balance sequentially approximately 25%, essentially our margin spreads actually – or our yield [inaudible] actually improved throughout the period. So I think it just adds kind of a factual element to the outcome. So not only do we have good growth, but we did not compromise either price of spread in order to grow.

<Q – Daniel Harris>: Great. Thanks a lot, guys.

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

<Q – Matt Snowling>: Yeah, good evening. I guess my question as far as the $1 billion of excess capital at the bank, I guess it seems that credit has clearly turned the corner. The bank is generating organic capital. So at what point do the regulators allow you to upstream more of that capital to the holding company perhaps pay down debt?

<A – Bruce Nolop>: That's something we just can't comment on, it's Bruce. And – but I think it is fair to say that now that the bank is generating capital, and as you noted, we already have excess, that's clearly a topic that we'll be discussing with the regulators as we go forward.

<Q – Matt Snowling>: All right, fair enough. Follow-up question on funding. You still have about $9 billion of repo and home loan bank funding. If I recall, a lot of that was hedged, so you couldn't necessarily let that roll off. But now that you're potentially taking gains, can you take those gains and break those hedges?

<A – Bruce Nolop>: The answer is we could, but theoretically, the loss though on the unwinding of the hedges would be so significant. And from our analysis, that would not make sense to do at this point. It perhaps will make sense in the future, but not now.

<Q – Matt Snowling>: Okay. And how long is that funding? What's the duration of that funding?

<A – Bruce Nolop>: The home loan bank loans are three to seven years, they'll be rolling off. And in terms of the repo and the hedge accounting related to them, they roll off over ten years.

<Q – Matt Snowling>: 10? Okay, thanks.

Operator: The next question comes from Mike Vinciquerra of BMO Capital Markets.

<Q – Michael Vinciquerra>: Thanks. Just a follow-up on Dan's question on the commission rate. I had a note from last quarter that you guys – the commission rate actually had stayed stronger because there was more stock plan administration selling, you get a higher commission rate there. And this quarter, it actually held up pretty well. Did you continue to see more than typical activity out of that particular segment?

<A – Bruce Nolop>: We saw good activity, but sequentially it would be down. And that's because you tend to have more exercises of particularly certain stock in the first quarter as well as option. So it's seasonality in that business. But overall, that business is performing very well for us, and it's a real strong point for the company.

<Q – Michael Vinciquerra>: Okay. So at this point, no reason to expect any major changes on the com – I know you get a mix shift, but on the commission rate, nothing to really flow through into the third quarter that you know about?

<A – Bruce Nolop>: No.

<Q – Michael Vinciquerra>: Okay. I wanted to ask on the loan securitization, just to make sure I understand the accounting there. You said you sold agency securities. Is there any sort of residual on that? Or is the residual already with you or your clearing partner anyway who takes care of the servicing of you? I mean I'm sorry, your servicing partner who takes care of that for you?

<A – Robert Burton>: No, there's no residual involved in that.

<Q – Michael Vinciquerra>: So you sold 232 million in loans and you actually got a small gain, so that was a cash transaction essentially to you guys?

<A – Robert Burton>: Yes.

<Q – Michael Vinciquerra>: Okay.

<A – Bruce Nolop>: And – right. And just to tell you the gain, it was 6 million gain.

<Q – Michael Vinciquerra>: Okay. And then one last thing – go ahead, I'm sorry.

<A – Robert Burton>: Just to be clear, we took back the security.

<Q – Michael Vinciquerra>: I see. Gotcha. Okay. Then just two line items, FDIC insurance premiums and servicing costs, I would expect those over time to be declining as the portfolio comes down and as your deposits run off at the bank. Is that fair, Bruce? Is there something specific to this quarter why we haven't seen any real improvement in those particular line items?

<A – Bruce Nolop>: The two things are, first on the servicing that will decline over time. But there are a few expenses related to REO that go through that as well and so it's not just a straight calculation; but directionally you are correct that it should go down proportionally with the decline in the portfolio being serviced.

And with respect to FDIC insurance, there is a mix issue. You have higher fees on brokerage cash than on bank cash for the deposit. But again, directionally, they should be relatively constant with the deposit base. But again, we don't see a big change going forward in the deposit base. Most of the decline in the bank has already occurred.

<Q – Michael Vinciquerra>: Perfect. Okay. Thank you very much.

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

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

<A – Steven Freiberg>: Hello.

<Q – Howard Chen>: Congratulations on the turn to profitability.

<A – Steven Freiberg>: Thank you.

<Q – Howard Chen>: The first question I had a follow-up on the non-advertising operating expense step down, what's the timing of those restructuring programs you mentioned, Steve? I guess I'm just trying to gauge how much of an incremental step down we should anticipate in the next quarter all else being equal.

<A – Steven Freiberg>: Yeah, we don't provide specifically on that front, so I'll turn it to Bruce -- yeah, okay. So I really can't give you a precise answer on that other than to say that now through the remaining two quarters in the year, those numbers basically should be really fully reflective of that past restructuring.

<Q – Howard Chen>: Okay, thanks, and then switching topics. If I thought about just this as a starting point of sustaining and growing profitability for the company from here, I guess one key in our minds is what's the ultimate size and mix of the balance sheet. Steve, hoping to get any updated thoughts you have on that.

<A – Steven Freiberg>: Yeah, I mean, it's a bit – as you would expect, it's a bit premature on that front to give you a specific number where this will become optimal. So I would say probably over the next several quarters, we'll have a much better sense of really the size of the balance sheet and where we find the right balance between what we deploy as the balance sheet income and returns, but that's what we're working on as we speak. What I can say, though, is particularly as what you've seen in the past that we're continuing basically to manage as we have been managing to reduce as substantial as we can, as quickly as we can the legacy asset book.

<Q – Howard Chen>: Okay, thanks. And then just – you're freeing up regulatory capital. It doesn't sound like you're that concerned about reg reform. Just remind us of any target bank and parent company capital ratios that you're sort of aspiring to.

<A – Steven Freiberg>: I can tell you what – at the parent level, from the standpoint of target on a regulatory basis the total capital to risk-weighted would be for 10%; tier 1 capital total adjusted five; tier 1 capital to risk-weighted would be six; and those would be considered by our regulators to be a well capitalized institution. And so those are sort of the thresholds that we have in mind at the holding company. And from the standpoint of the bank, I don't know Bruce if – we're actually where – as we said, we're well ahead of the statutory requirements.

<A – Bruce Nolop>: Yeah, and we haven't at this point established any targets for the parent above what's been published as the official threshold. But for the bank, what we've said is that even though the well capitalized threshold is 5% on tier 1 capital to total assets that we're targeting 6%. And with respect to risk-based capital, we've said we wanted to be in excess of the 10% threshold by at least 500 million. So if you think about it, we have $1 billion of excess capital now, and of that 500 is above what we target internally.

<Q – Howard Chen>: Okay. Thanks. That's helpful, Bruce. And just a quick numbers clean-up, what was the end-of-period share count?

<A – Bruce Nolop>: In terms of the actual shares outstanding, it would be 210 million. And in terms of the fully diluted it would be 290 approximately, and we're seeing if we can get any more specific than that. than that -

<Q – Howard Chen>: 220.4 is the actual outstanding at end of period.

<A – Bruce Nolop>: Oh, I'm sorry, 220. I'm sorry, 220.

<A – Steven Freiberg>: And fully diluted, do you have it there?

<A – Bruce Nolop>: It's 290.

<A – Steven Freiberg>: 290?

<A – Bruce Nolop>: 290.

<A – Steven Freiberg>: Okay. So 220 and 290.

<Q – Howard Chen>: Great. Thanks so much, and congrats again.

<A – Steven Freiberg>: Thank you.

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

<Q – Michael Carrier>: Thanks, guys. First question, just on the balance sheet, the movement in the segregated cash, just wanted to figure out what that was due to. And then just the comment that you had of increasing the balance of the held to maturity, just based on that shift, what you're seeing, just any comments on sensitivity to interest rates or NIM outlook?

<A – Bruce Nolop>: Sure. First of all on the segregated cash, this is actually a good story. It's got two components. First is the growth in our margin balances that that set of receivables is financed out of the segregated cash. So the fact that we grew our margin book by about $1 billion during the quarter that reduces your segregated cash. And secondly, we were able to move $1 billion from segregated cash into our Sweep Deposit, and what that does is give us much more flexibility as to how we can invest it of the amount that's in excess of margin receivables. So that's why you saw the decline in both cases from our standpoint really a positive movement.

And in terms of the net interest spread, just to comment overall rather than on the held to maturity portfolio is just we think that we're going to be able to maintain the spread approximately where it is now and are targeting around a 300 basis point spread for the next few quarters.

<A – Steven Freiberg>: Yeah and just to put absolute context to it, you know, we reported in the quarter 289 basis points, down seven from the prior quarter as we held more cash through the quarter on average but invested basically above those averages by the end of the quarter. And to Bruce's point, our expectation is that we can target and maintain over the coming quarters mas o menos about a 300 basis point spread, so a little bit better than where we were in the second quarter, as we deploy basically or better utilize the cash balances in the enterprise.

<Q – Michael Carrier>: Okay. And just a follow-up. You know, I think a lot of banks, you know, you're obviously seeing the benefit from either reserve releases or improving credit. And I think what you try to get your arms around is if you look at like the top line growth, you know, in an environment where DARTs were up, margin balances were up, you still had pretty much like flat revenues ex the provision. So, I guess, as the balance sheet shrinks and I'm trying to just, I know you can't gauge exactly where that's going, but if you look at brokerage cash or cash held by brokerage customers it's 20 billion that would be like the online brokerage business. So maybe it's 20 to 30 billion. I'm just trying to understand like what's the offset, meaning where are there areas to grow the business, so as you're constantly shrinking the balance sheet there's still opportunities to grow the earnings.

<A – Steven Freiberg>: Yeah, let me put perspective to it. If you think about E*TRADE or the industry, first and foremost, the trading business as I think you made a point on DARTs has its own inherent volatility, although if you look over long trends, we expect that business broadly as an industry, may not be specific to E*TRADE, probably grows at 5 to 7% a year obviously with a lot of volatility in between.

I think secondarily particularly for E*TRADE we have a longer term opportunity basically to better serve and therefore better translate into economic benefit for E*TRADE more of the investor population which is somewhat distinct from the trading population. We have a large and better base of those folks and we've begun over the last year to provide, build, develop more product and service that would provide I think the relevant level of value prop to those folks although we still have a lot of opportunity ahead of us there. So it's an area of opportunity.

I think thirdly I think to your point, the bank which has been a source of both kind of economic profit on the deposit side clearly the downside of that is a lot of that historically was invested in assets that never did turn out to perform the way we had expected. But over time as that normalizes, the bank, whether it invests basically in securities or any other asset, should be a very profitable enterprise for this entity.

And then finally, and I think Bruce covered it in piece, we have some terrific secondary – not second tier businesses but secondary businesses, particularly in market-making, particularly in corporate services we provide both options and restrictive stock plans to a number of companies who are strategically important to us, [inaudible] of our new customers come through there. We have plenty of options to grow. We just have to basically get our house fully in order, which is really what we've been accomplishing over the last I think several years, culminating in a very good quarter this time around.

But we have, I think many options, many levers to grow the firm. In my first 100 days or so here, what I've basically tried to do is to understand the industry, understand E*TRADE, and then begin to start to synthesize these into what the right set of priorities would be, so that we can actually grow the top line, as well as benefit from what you've seen on the bottom line. But the goal is to basically have the concert play all the instruments top and bottom, so we kind of play it out.

<Q – Michael Carrier>: Okay, that's helpful. Thanks a lot.

Operator: Next question comes from Brian Bedell of ISI Group.

<Q – Brian Bedell>: Hi, good evening. Can you hear me?

<A>: Yes.

<A>: Yes.

<A>: Yes.

<Q – Brian Bedell>: Okay, great. I guess just following on the – real quick on the balance sheet. Just for example, if you were reducing the [inaudible] by about let's say a billion a quarter, and let's say over the next eight quarters it's down by 8 billion or so, is it your intention to really reinvest that in securities or to reduce the funding cost side of the balance sheet, if you had to sort of choose one way or the other?

<A – Steven Freiberg>: Yeah. It's a good – I think it's a good challenge for us. And I'm not sure the answer is binary either. And we'll look at basically the tradeoffs, and the tradeoffs typically are many. One would be from the standpoint of freeing up capital, how best to deploy it back into the firm. So it gives us more degrees of freedom. Second is basically growth and profitability. And finally from a broader based strategic standpoint, what are the best options for this particular company. But the trend is – has been from a factual standpoint, as we freed up essentially the cash, or freed up basically the liabilities from the asset as $1 billion a quarter's rolled off, we have fundamentally reinvested in largely agency securities. I mean that has been the strategy up through now. It doesn't mean that we'll sustain it in its absolute form, but I would say though that that will still be a very important part of what we do.

<Q – Brian Bedell>: Right. Okay. So it's sort of like by quarter-by-quarter you think about how the strategy plays out?

<A – Steven Freiberg>: No. I think that we're going to have a more comprehensive view. But I'm just saying if you look at basically recent history, that's what the strategy has dictated and what the company has executed against.

<Q – Brian Bedell>: Right. Okay. And then this question may be a little premature, but as you return to more sustained profitability and provisions eventually will come down pretty significantly. How do you think about the cost structure of the company, let's say 12 – 24 months from now in terms of what kind of things you'd like to spend money on that you haven't been able to spend on in the past?

And maybe if you can just touch on, maybe four buckets of that, such as number one, incentive compensation, number two advertising, number three investments in the franchise, and then number four in terms of the FDIC assessments coming from re-reg, are you impacted by any kind of assessment change in – assessment calculation change in that regard?

<A – Steven Freiberg>: How many questions?

<Q – Brian Bedell>: I'm sorry, I was -- I guess basically just touch on maybe the – I guess I'm looking for incentive comp and then obviously advertising, as you become much more profitable and to what degree do you feel you have freedom to really investing much more in the franchise?

<A – Steven Freiberg>: Yeah, let me take a shot at it. One on several fronts, as the overall profitability and health of the company continues to improve. As we said, I think both in the release and in our commentary, it gives us many more degrees of freedom to pursue the opportunities that we think are best suited for the company. And they probably will fall into several categories. We would like to intelligently enhance our marketing spend, where it makes sense. And there is a whole host of ways to do it. Some actually cost money. Some basically cost really kind of time and resources more than explicitly money. So I'll just give you some examples.

As we speak, we're working on basically kind of new prospect home pages. We're working on basically reorienting our advertising. You'll probably see more of that coming into the late third or into the fourth quarter, more aggressive acquisition offers, and actually importantly where it's not so much spend, but more of segmentation analytic, lot of testing and learning that we have approximately 15 million prospects that come to our website annually.

We have reasonably good conversion rate measured by industry standards. But there's an immense opportunity we believe to do better and in addition to that, we have a large number of customers who come to us, who open accounts but never fund, we think we have a large opportunity to do better and that's through being smarter about the touch points and the throughputs and basically how we can bring them from I would say hollow accounts to more productive accounts.

In addition to that, which really was started in the latter part of 2009, we started to bring more relational service and relational sales people into the company and again our costs are coming down as we're basically putting on a higher caliber person to interface with our customer base and we'll continue to invest in that because sort of the payback model looks reasonably good.

In addition to that and a bit more tactical working on things like portfolio margining, three and four legged spreads, working on basically leveraging what I would say are more common aspects in – particularly in the online segment today like communities, we can go on and on and on and on. So there is a lot of opportunity ahead of us. Question is prioritization and then how we fund it without bloating a cost base. So in a perfect world, we'll be smarter and we will be leaner and more productive and it is a bit premature, but that's sort of a direction we're taking the company.

<Q – Brian Bedell>: Yeah, that's fantastic color. And so I guess you will sort of balance the cost of that versus sort of the operating margins that you're showing?

<A – Steven Freiberg>: That's correct. That's correct, and each one basically will be measured where it's appropriate as kind of an independent event and has the base picked out on its own liability from the standpoint of not only the P&L but the return that this company will realize.

<Q – Brian Bedell>: Right and then on a full year basis does the incentive comp structure change dramatically if you show say profitability on a full-year basis?

<A – Steven Freiberg>: I would say there is a correlation, but it's not the traditional wire house or investment bank. And so the correlation is going to be relatively mild.

<Q – Brian Bedell>: Right, right, okay. And then just lastly on the share count, so we're at 290, is that a good run rate for the third quarter? And then if you convert – I think the conversion is already in the share count, is that correct?

<A – Bruce Nolop>: That's correct. 290 is a good number. And...

<A – Steven Freiberg>: 290 is a fully converted number.

<A – Bruce Nolop>: Right. And the reason why that's appropriate is when we shifted from a loss to a gain, you move from the basic shares to the fully diluted, so 290 is the assumption, assuming that we continue to be profitable. That's the – and if it were still a loss that you assume, then you would use the lower 220 number.

Operator: The next question comes from Faye Elliott of Bank of America.

<Q – Faye Elliott>: Hi, thanks for taking my call. It appears from the guidance that some of the operating trends, I guess, moved more positive toward the end of the quarter, and maybe could be reflected next quarter in stronger sustainable operating numbers. And I guess to that end, are you seeing higher prepaid given the rate environment toward the end of the quarter? And has your outlook for loan runoff shifted based on that?

<A – Paul Brandow>: It's Paul Brandow. We really haven't seen much of a change in the prepayment rates recently, and the current levels are what we reflect in our current provision and in our allowance.

<Q – Faye Elliott>: Okay. And you don't expect that to increase at all? You don't expect run-off to increase just based on rate levels currently?

<A – Paul Brandow>: We haven't seen it, and unless we see a change in behavior, we're not planning on it.

<Q – Faye Elliott>: Okay. Thanks a lot.

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

<Q – Joel Jeffrey>: Thanks, guys. Most of my questions have been asked and answered. But just a couple of housekeeping questions. I know said that DARTs volumes were pretty good in the quarter. Can you give us a percentage of what the options were in that category?

<A – Bruce Nolop>: They were 16%, if I recall, yeah. 16%.

<Q – Joel Jeffrey>: Okay, great. And then in terms of the margin balances, some of your competitors have said that there tends to be a lag effect and I know with the equities markets being up in the past few quarters and declining recently. Is there a chance that we see the balances come back down in future quarters?

<A – Bruce Nolop>: There's certainly a chance, but I think that in general margin balances would tend to grow if the market is viewed as an attractive place for them to buy more securities. So, I think, it's going to be a function of where the market goes to some degree.

<Q – Joel Jeffrey>: Okay. Great. And then just lastly, in terms of deposits, I know you guys had a sale of deposits in the past quarter. Are you guys still actively looking to sell deposits?

<A – Bruce Nolop>: No, we're not.

<Q – Joel Jeffrey>: Okay. Thanks so much.

<A – Bruce Nolop>: You're welcome.

Operator: Your next question comes from Leon Cooperman from Omega Advisors.

<Q – Leon Cooperman>: Yeah. Actually, my question was asked. I'll electioneer for my question. Going on the theory that a penny saved is a penny earned, we have a big negative spread on our outstanding debt versus what we're earning on our cash. We're generating cash. We're building cash at the holding company. I know it requires regulatory approval, but I would encourage you to look that regulatory approval to take out some of this debt to improve our net interest margin so to speak.

<A – Bruce Nolop>: It's clearly on our radar.

<Q – Leon Cooperman>: You answered the question. I just wanted to electioneer for it. That's all, but thank you. Great job by the way. Great job, good call, good responses. Thank you.

<A – Bruce Nolop>: Great.

Operator: This concludes the question-and-answer session of today's call. I will now turn the floor back over to Mr. Steven Freiberg for any closing remarks.

Steven J. Freiberg, Chief Executive Officer

Thank you, operator and thank you for joining us tonight. This was an important quarter for E*TRADE as we continued to make substantial progress towards sustainable growth and profitability. We look forward to speaking with you again next quarter. Good evening.

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