MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen, and welcome to the third quarter 2004 Earnings Conference Call for E*Trade Financial Corporation. I've been asked to begin this call with the following Safe Harbor statement. During this conference call the company will be sharing with you certain projections or other forward-looking statements regarding future events or its future performance. E*trade Financial cautions you that certain factors including risks and uncertainties referred to in the 10-Ks, 10-Qs and other reports it periodically files with the Securities and Exchange Commission could cause the company's actual results to differ materially from those indicated by its projections or forward-looking statements.

In this call E*trade Financial will discuss some non-GAAP measures in talking about its performance and you can find the reconciliation of those measures to GAAP in the company's press release, which can be found on its web site at www.etrade.com.

This call is being recorded. A replay of this call will be available by telephone beginning at 7:00 P.M. Eastern Time today through 9:00 P.M. Eastern Time on Monday, November 1. This call is also being web cast a www.etrade.com. No other tape recordings of this call or copies of the tapings are authorized or may be relied upon.

I'll now turn the call over to Mitchell Caplan, excuse me, sir, Mr. Mitchell Caplan, Chief Executive Officer of E*Trade Financial Corporation, who is joined by Jarrett Lilien, President and Chief Operating Officer, and Mr. Robert Simmons, Chief Financial Officer. Mr. Caplan, you may begin your conference, sir.

Mitchell Caplan, Chief Executive Officer

Good afternoon and thank you for joining us today. This past quarter once again validated our business model, producing earnings of 21 cents per share compared to 24 cents in the prior quarter, which is before a one-time gain on the sale of our ATM business, and 17 cents per share in the year ago period. At the segment level we produced 18 cents in earnings per share compared to 21 cents in the prior quarter, and 19 cents a year ago, excluding restructuring charges.

It is important to note that in the third quarter of last year we enjoyed both a strong equities market and a strong mortgage market. This past quarter we saw neither. However, significantly increased efficiency in our brokerage segment offset a sluggish equities market, and further improvement in our bank spread more than offset a slowdown in the mortgage market. The result? We remain on track for the strongest year of revenue and earnings in our company's history.

As we enter the last quarter of 2004, it is worth reflecting on our positioning in the financial services industry. We always have and will continue to use technology and a cost effective platform to differentiate from traditional brick and mortar competitors. In the early stages of our company this often translated into offering outstanding pricing on a narrow selection of products. In this first phase our focus was to insure that the model worked and that we could succeed against traditional competitors.

In the second phase of the company's development we added new products and new lines of business. In all of these new areas we adhered to the same core tenets of technological innovation and operational efficiency, and yet we knew that to unlock the true value in our model we had to move to a more integrated approach to our customers and to our business.

We are now in the third stage of our development. In it we have focused on integration to build a franchise that is differentiated and compelling. We are uniquely positioned to succeed. We are more nimble and more cost efficient than our traditional competitors, and we are the only company in the on-line segment that offers an integrated suite of trading, investing, banking and lending solutions, and yet still has a highly efficient cost structure. This combination has created a compelling offering for our customers.

We have built a flexible and scalable infrastructure that has always allowed us to effectively compete on price. More importantly, it is allowing us to extend our value proposition to include superior service and functionality. To be clear, price will always be an important component of our value proposition. But as we continue to build relationships with customers, we are augmenting price with outstanding customer service and unique functionality.

In a few minutes, Jarrett will spend more time talking about some of our recent accomplishments in these areas. There is perhaps no better proof point of our success in creating a differentiated and compelling franchise than the Sweep Deposit Account. Since the launch of this account in September of 2003, we have moved approximately $5.6 billion onto the bank's balance sheet. As a cost effective source of deposits for the bank, the Sweep Deposit Account has reduced the bank's cost of funds by 75 basis points, which will generate over $180 million in incremental annual pre-tax earnings. This income growth could only be delivered by an integrated model like ours.

Importantly, we have today delivered greater value for and deepened relationships with the more than 1.3 million brokerage customers that we have moved into the Sweep Account. We have been able to reinvest these earnings, generated by our diversified integrated model, even as competitors wait for market conditions to recover. We have reinvested in technology, in operations, and selectively in marketing. These initiatives will translate into better pricing, service, and functionality for our customers. We can afford to make these investments proactively, while others are riding out downturns and market fluctuation.

We have only just embarked on this third phase in our company's evolution. As we refine our strategic objectives and finalize our operating plan for next year, we are focused on creating an organization that delivers on its true potential. We will be talking to you in more detail about these plans in December when we host a conference call to discuss our outlook for the coming year.

I'd now like to turn the call over to Jarrett to discuss some of the steps we have taken to execute on our vision.

Jarrett Lilien, President & COO

Thanks, Mitch. As Mitch stated, it was a solid quarter. Despite industry-wide weakness in trading volumes, operating margin held flat sequentially at 30% and increased from 14% a year ago or from 26% excluding restructuring charges. Our ability to generate margin improvement in a soft environment speaks to the power of our efficient and integrated platform.

We are seeing encouraging evidence that trading volumes may have bottomed in August, total DARTs increased 11% in September, and October volumes are trending up by an additional 17% through the first 10 trading days of the month. This increased trading activity should translate into further margin expansion in the fourth quarter, since we do realize a pre-tax margin of 85% on an incremental trade.

Turning now to the segments, we continue to create value by focusing on price, service and functionality. Starting with the brokerage segment, we continue to gain market share while we hone our value proposition. To better attract serious investors, in September we reduced the expense ratios on our proprietary S&P 500 and international stock index funds to the lowest level in the industry at 9 basis points. We also launched a comprehensive Exchange Traded Fund center that provides customers with research, news and screening tools, specific to ETFs.

With the combination of our 12b-1 mutual fund fee rebate program, the lowest cost stock index funds in the industry, no fee IRAs and our highly competitive commission rates on equity and option trades, we believe we have created the most compelling value proposition in the industry for the serious investor.

We also continued to improve our offering for active traders. This month we launched a major upgrade to our Power E*Trade Pro platform, improving the user interface and enhancing option trading for our professional customers. We are also seeing a strong response to advanced option chains for our active customers.

Through the first three quarters of 2004 we have increased brokerage segment revenue by $74 million over the same period last year. During this period the brokerage segment has generated an incremental $78 million in earnings, excluding restructuring charges in year-ago period. The $78 million includes an incremental $17 million in marketing spend. In other words, during 2004 we have been able to drop over 105% of our incremental revenue to the bottom line. This is a significant proof point of the efficiency and scalability of our business.

In the banking segment we continue to increase core earnings. During the year, Fed funds have increased by 75 basis points, and during that time we have seen, as expected, a decline in mortgage originations. But this decline has been more than offset by our spread which has increased continuously during the year. This quarter, rising interest rates improved asset yields, while the cost of our liabilities increased at a slower pace. Exactly the dynamic that we have spoken about in previous calls. As interest rates rise we are well positioned to further improve spread.

During the quarter spread rose from 205 basis points to 213 basis points. This improvement was driven by an 8 basis point increase in our asset yields, more than offsetting a 3 basis point increase in our cost of funds that was generated by repricing our liabilities. Additionally we improved our spread by 3 basis points as we swept an additional $800 million into our Sweep Deposit Account.

As we look to create a holistic cash management solution for our retail customers, we are evaluating the best way to optimize the remaining 4.7 billion in brokerage customer cash by moving it onto the bank's balance sheet.

We continue to improve spread, also maintaining our commitment to high credit quality. The average FICO score of our total loan portfolio remains above 730, and charge-offs remain below industry averages. The transformation of the bank's earnings is a significant proof point of the power of our model. Of the 11 cents of earnings produced by the bank, only half a cent came from our mortgage operation, while 10.5 cents came from core banking earnings. Year to date 90% of bank earnings have been produced from core banking activity versus 10% from our mortgage company. This compares favorably to last year when nearly 50% of the bank's segment earnings came from the mortgage company and highlights the improvement in the quality of bank related earnings.

Turning to service and operations, we continue to improve our sales channels and our back office operations. In September we opened a new retail financial center in Costa Mesa, California, marking our ninth center nationwide. We believe that these centers strengthen our value proposition, particularly to the wealth building segment, by enabling us to offer an important point of contact to access our investing, banking and lending solutions. Our strategic approach to branches is simple; target key metropolitan markets where we have strong brand recognition, a large number of existing clients, and a high potential for asset accumulation. The centers are highly cost efficient. The fixed costs associated with running all 9 locations is just $3 million annually.

In our back office we combined check processing, wire and account opening functions, making for a better customer experience while also reducing operating costs. More importantly we successfully completed one of the largest infrastructure projects in our history by replacing our core processing and clearing system. Our new ADP system eliminates legacy technology and significantly improves the leverage and flexibility of our platform. The system is the backbone of our integrated value proposition. For the first time we are poised to deliver one global platform across our domestic and international retail institutional and professional businesses.

With that I'll turn the call over to Rob for the financial details.

Robert Simmons, Chief Financial Officer

Thanks, Jarrett. In the third quarter of 2004 total consolidated net revenues equaled $337 million, a decline of 11% from the prior quarter, and 13% from the year ago period. At the segment level net brokerage revenue totaled $199 million, declining 17% compared to the prior quarter and year ago period.

Net banking revenue totaled $151 million, declining 1% compared to the prior quarter, and 2% from the year ago period. Despite a weak trading environment, our model continues to deliver. The multiple offsets and points of leverage continue to provide relative earnings stability in a down brokerage market, while maintaining significant leverage to the upside in a recovery.

In the third quarter we produced earnings of 21 cents per share, down 3 cents from the prior quarter. Of the 21 cents earned in the quarter, 18 cents was at the segment level with 3 cents from corporate items. Bridging the segment results from the second quarter to the third quarter, brokerage earnings declined by approximately 3.5 cents to 7 cents. This sequential decline was driven by 4.5 cents on lower DART volumes, offset by a 1 cent pickup from lower expenses.

At the bank earnings decreased – or increased sequentially by half a cent to 11 cents. The half cent increase was the net result of a 2 cent increase from higher spread and a larger balance sheet, offset by a penny and a half from lower fee income, higher provision corresponding to the growth of our balance sheet and the decline in profit from our mortgage business. At a half a cent in earnings per quarter the mortgage business is exactly in line with our guidance outlook for the second half of the year as we gave last quarter.

As Jarrett stated, over the past several quarters we have successfully improved the quality of bank earnings with a shift toward recurring spread related income. In the third quarter net interest income represented 83% of net banking revenue, up from 75% in the prior quarter and 40% a year ago. We ended the third quarter with total cash and equivalents of $731 million, and free cash of $713 million, a sequential decline of $4 million. Free cash as we define it represents cash of approximately $400 million held at the parent company, and excess regulatory capital at the Bank and Brokerage segments.

With $713 million in free cash we are pleased with the level of cash that the business is generating, the lower debt we now carry and the liquidity that we maintain. We are now in a strong position to evaluate opportunities that include downstreaming capital to the bank or brokerage, strategic acquisitions and buy-backs, including debt retirement and share repurchases.

During the third quarter the business generated $80 million in cash net of tax. We added another $53 million in cash through the continued sale of our equity investment in SBI. We reinvested $20 million in stock repurchase, $22 million for CapEx, and $95 million in additional regulatory capital at the subsidiary and other items for a net decline in free cash of $4 million.

As we enter the fourth quarter we are now realizing the full benefits of the capital and balance sheet restructuring initiatives that we began in April and completed in mid July. We continue to expect the refinancing of our convertible notes to be accretive to annual earnings by 2 cents per share due to reduced interest expense and the elimination of 30 million shares. This debt restructuring, in addition to share repurchases, reduced our diluted share count in the third quarter to 381 million from 417 million in the prior quarter.

We benefit from multiple leverage points in our business. Through our broad range of financial solutions we are able to generate revenue and profits in a variety of market and economic environments. Undoubtedly trading volumes have been weaker in 2004 than we originally anticipated. Yet despite softer than forecasted brokerage related earnings, we have been able to raise our 2004 guidance throughout the year. I'm pleased to announce that we are again raising the low end and narrowing the range of our 2004 earnings guidance today to a new range of 92 to 97 cents per share from our previous range of 87 to 97 cents. This new earnings outlook implies a fourth quarter EPS range of between 17 and 22 cents per share based on the 75 cents we have earned to date, which includes the one-time 7 cent gain in the second quarter from the sale of our ATM business.

In this year's volatile economic environment, the value of our integrated brokerage and bank model has never been more evident. We remain extremely pleased with the performance of the business and the consistency with which it continues to deliver solid financial results.

We are generating exceptional cash flow and we stay committed to seeking the best uses for our cash. We will continue to deploy capital against high return opportunities where we drive value to our shareholders. With that we will now open up the call to answer your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. The floor is now open for questions. If you have a question, please press star and the number 1 on your Touch-tone telephone. If at any point your question is answered, you may remove your question from the queue by pressing star and the number 2 on your Touch-tone telephone.

Please limit yourself to one question and one follow-up. We do ask that while you pose your question, that you pick up your handset to provide optimum sound quality.

Your first question comes from the line of Matt Snowling of Friedman, Billings, Ramsey.

<Q – Matt Snowling>: Good afternoon. I'm going to try for two questions if I can. At the end of the quarter what did the bank spread end up at? It was 213 on average.

<A – Mitchell Caplan>: And we exited at 213 as well.

<Q – Matt Snowling>: 213? Real quick on the ADP conversion, are you going to give us any guidance in terms of what that does for costs saved going forward?

<A – Mitchell Caplan>: We will when we go through '05 guidance in December.

<Q – Matt Snowling>: Okay. I'll get back in the queue then.

Operator: Your next question comes from the line of Scott Patrick with Morgan Stanley.

<Q – Scott Patrick>: Hi, guys. Just in terms of the comp line this quarter came down considerably from the run rate we've been seeing. Can you put a little bit of color on that? If I could just ask one more quick on brokerage accounts. Looks like you lost a few accounts this quarter. I know that advertising expense was quite low, but can you give us some color on what types of accounts you were losing?

<A – Mitchell Caplan>: Yeah, absolutely. So let me start with the comp. One thing that you'll find that's interesting is if you look at comp as a percentage of revenue in Q3, it was flat with Q2. So although it did decline it stayed pretty consistent as a percentage of revenue. Secondly, the significant drivers in the decline in compensation were, 1, evidently the variable comp structure that's in the brokerage business related to the corresponding revenue, which is why you see it in line, as well as a significant decline, about $4 million just in the mortgage business and the mortgage operations from lower headcount there as a result of lower origination. So the two key drivers were clearly the mortgage business and then the variable comps associated with that part of our brokerage business.

<Q – Scott Patrick>: Is this a good run rate then in terms of percent of revs?

<A – Mitchell Caplan>: Yes, it is. And when you look at it it's certainly a good way to think about it is a percentage of rev.

<Q – Scott Patrick>: Okay.

<A – Mitchell Caplan>: Secondly, on the brokerage account side, a couple things. One is, one of the things we are focused on is if you look at the 3 lines, you look at gross accounts and we are pleased with the gross account growth there, if you look at both closed accounts and inactive accounts, we are probably a little less focused right now on the inactive account line and more focused on the closed account line. Closed account is where a customer actually chooses to attrit and leave us, and so we have dramatically increased our focus in the last quarter or two on trying to reduce that. And for the first time in a while you are seeing that number actually go down quarter over quarter. So we are doing a better job at attriting less of the customers that we truly want to keep and create value for us. In the inactive line it's usually people, as you well know, who haven't actually left. We are just not counting them anymore as an active account because they are either not trading or dropped below the asset level. So it's pretty clear to look at those customers and say the amount of revenue and profit they are driving for us is pretty marginal, compared to the growth in new customers that we are seeing. And one of the other things that we've been a little bit more focused on as a team is not necessarily growth in accounts, but trying to do more with the accounts as they exist with us. And in the brokerage world Lou would tell you he focuses as much on assets and on margin balances and on trading behavior as he does on just accounts. So were we in a place where we were growing market share around the assets of our customers? And the answer to that is we absolutely are. Our market share and assets is up from 2.6 to 3.1% this year. Our margin market share is up from 7.8 to 10.8, and we continue to gain market share around our trading volumes. And we view those three things as the significant indicators of future revenue growth and profit.

<Q – Scott Patrick>: Great, thank you.

<A – Mitchell Caplan>: Sure.

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

<Q – Rich Repetto>: Yeah, hi, guys.

<A – Mitchell Caplan>: Hi, Rich.

<Q – Rich Repetto>: How you doing? Hey, Rob, can you walk us through – I guess the first question would be the 95 million in capital, you said the use of cash was 95 million. Could you just give a clear picture on where that's going for, I guess you said regulatory capital?

<A – Robert Simmons>: Yeah. Just to be clear, basically we generated, Rich, $80 million of cash kind of from operations. And again, just to be clear, I would encourage you guys when the Q comes out, that we will publish a GAAP cash flow. But as a shorthand you can think of it as pre-tax income this quarter was about 118 million. If you back out actual tax payments, you know, and add back depreciation and amortization and back out the gain that's in that number, that's related to the sale of SBI shares, that's how you get to your 80 million in cash generated from operation. So you take the 80 million plus the 53 million in SBI proceeds that we actually received in cash that gives you $133 million of cash that was kind of available to do something with. We used 20 million of that to buy back our own stock, we used 22 million of it for CapEx, and then 95 million of that was deployed in additional regulatory capital, primarily at the bank as we continued to grow the balance sheet at the bank. So that nets out to your 4 million decline in that metric that we call free cash.

<A – Mitchell Caplan>: For example, Rich, if you look in the growth in average assets and ending assets at the bank you'll see it having grown by about a billion to a billion 2, sort of in that range. If you assume you are keeping somewhere between 5 and 6% core capital or 10 to 11% in risk based capital, as your gating factors on that growth alone it accounts for the significant portion of the capital that was needed in the regulated entity.

<Q – Rich Repetto>: Okay. That makes sense there. I guess the follow-up question is a little bit more – I got to ask a little bit more about growth and where the model goes from here. You know, Jarrett talked about the integrated – the differentiated integrated model. Where else, you know, investors are looking and they give you credit for the sweep and how well you've done there. But where else do you see benefits, even in a broad outline of how you can integrate the bank and the brokerage?

<A – Mitchell Caplan>: Happy to do it. So we will give obviously much more specific answers to your questions in December when we talk about 2005. But at a high level I think we have 4 or 5 key drivers. On the brokerage side we obviously continue to remain fairly leveraged to a return in trading volume, like those of our other competitors who are out there who are looking for trading volume pickup. And we have virtually the same incremental operating margin or higher at about 85 or 86% on each dollar of revenue around that trading volume. As well, as I said earlier, we have become really focused this year on the serious investor and on gaining share in assets. I talked earlier about the growth in asset share. That will allow us to generate more revenue in earnings as well. And if you look at serious investors as a segment, it has grown dramatically to now over 20% of our total customer base. So again, you've seen significant growth as we've focused on the products and the marketing, in order to continue to grow assets and drive revenue around that part of the business. When you move over on the banking side, you've got cash management, a great way to think about it is so far as we indicated in the call, we've swept about $5.6 billion from brokerage cash onto the bank's balance sheet, generating over $180 million in incremental pre-tax earnings. As Jarrett stated clearly, still in the system is $4.6 billion of cash which has not yet been swept. It is a larger number than we originally talked about, because when we first started to think about sweep, we thought about it in the context of money market funds. And now we are recognizing that if we really to your point want to be more integrated and we want to think about a retail customer, that retail customer is going to have a need for cash management, and we should be looking at total cash in our system and how we manage it. So that grew the base available to sweep by another $2 to $3 billion. So arguably you'll see us as we go into Q4 and into '05, begin to look at structural changes to be able to sweep that 4.6 billion. But if you recognize that 4.6 or 4.7 is left and the 5.6 has generated $180 million in growth in earnings there is a lot of potential there. Finally on the revenue side as you begin to look at the lending products that we've sold, we've done a great job at being on plan this year. We've basically hit mortgage originations dead even with what we guided, and we've hit our Ganis, or consumer finance at about 70 to 75% of budget. However, one of the areas that I think we need to focus on going forward is that the retail customer's lending needs solved the growth in the asset side of our balance sheet. Just like you are beginning to solve their cash management needs and selling them a cash product, and that funds the deposit side and the growth in the liabilities of your balance sheet, we similarly should be growing the asset side of our balance sheet by selling them lending products and putting them on. And that's what you'll see us focus on as we go into next year into 2005. Finally with respect to just growth in earnings, it's the good old-fashioned lowering your costs. And again, we've talked about ADP as one of the most significant steps, but again, as we talk about '05 in December, there are other actions that we intend to take as we integrate Bank and Brokerage, back office entirely now under Josh's leadership in a way to continue to drive significant costs out of the business. All of that gives you an explanation I hope for growth in top line revenue and in bottom line EPS. Then the magic question becomes how do we think about marketing and what do we want to spend on marketing as we build out our brand and sell our products in a more integrated way.

<Q – Rich Repetto>: Okay. Thanks, Mitch. I wanted to learn more about the structural changes, but I'll get back in queue.

<A – Mitchell Caplan>: Yeah, I hear you and we'll talk about them more in December.

<Q – Rich Repetto>: Okay. Thanks.

Operator: Your next question comes from the line of Mike Vinciquerra of Raymond James.

<Q – Mike Vinciquerra>: Good afternoon, guys. A question on the brokerage side and then one on the bank as well. I wanted to just ask, the pricing environment has become obviously a bit more competitive with some higher priced folks coming down into your neck of the woods, so to speak, and also presumably offering a little bit higher service level in terms of just having branches, and I'm talking about Schwab and Fidelity, of course. Just curious what your thoughts are in terms of any pressure for you guys to consider further reducing price. You've already done so in a couple of different cases and I'm wondering if you see any pressure on the revenue line there.

<A – Mitchell Caplan>: You know, I've said this for a while and I remain pretty consistent and steadfast in the view that I think you are unlikely to see a true price war in the brokerage business. I just don't think it's in anyone's interest and I don't think any of the players in the marketplace have any desire. Rather I think what you will continue to see is a focus on customer segmentation on offering the right product at the right price with the right level of service and functionality for that customer segment so you can gain market share. You've seen us do it. I think we've experienced a great deal of success. When I look at the marketplace at large, there has been no new price points established. When you look at Schwab's actions, when you look at anybody else, they are making themselves more competitive in the marketplace, I suspect to try to stem some of the attrition or market share losses that they were seeing. And even as we look at the behavior of everyone in the marketplace including Schwab, it's interesting to see that they were down less than we were this quarter in trading volumes. Part of that I think is their pricing and stemming their attrition, and part of it quite frankly, is that their customer base seems to be more centric to Dow traded stocks as opposed to NASDAQ traded stocks. Which is why when you see the uptick that we are experiencing this month in October, and we just talked about it - less than what – I mean it's greater than what Schwab had talked about in October. So I think there is a little noise in it. But in general, as we look at the marketplace we think that the most important thing is to figure out how we offer an integrated pricing. We offer relationship pricing and we make sure that we keep our cost structure at all times in alignment with the products that we are offering, so that we can make sure that we have value that's consistent to the customer.

<A – Jarrett Lilien>: And when you talk about the branch issue, it ties into what Mitch just said, keeping our costs under control. We've got 9 branches nationwide to date already servicing over 20% of our serious Investor customers. So starting fresh and coming in with that clean slate, we are doing it in a cost efficient manner, and I probably would go as far as to say that others are probably a little overbuilt out on the branch side. And again, as I pointed out, when we were talking about the earnings, you know, the total annual cost for our 9 branches is $3 million.

<A – Mitchell Caplan>: Right, so I suspect what you will see is branch infrastructure coming down at some of the other competitors, because they just can't afford it, and us being much more prudent in terms of how we look at our distribution channels and the costs associated with them.

<Q – Mike Vinciquerra>: Okay. I think I actually remember Mr. Schwab being quoted in the last couple of weeks as saying he'd like to see pricing on a trade driven down to zero but I don't know if that was true or what was behind that. But at any rate a second question, I appreciate your explanation, the net interest margin, it looked like the bump up in your yields was predominantly focused on your investment securities; they were up about 35 basis points on average. I'm curious if that's where you have the leverage to the higher short-term interest rates in terms of the way you've structured the balance sheet, in terms of the way you structured your hedges and so forth?

<A – Mitchell Caplan>: Absolutely.

<Q – Mike Vinciquerra>: Fair enough. Thank you.

Operator: And your next question comes from if line of Colin Clark with Merrill Lynch.

<Q – Colin Clark>: Good afternoon. First at the bank, you touched on some of the growth initiatives there. I was hoping to get, to the extent you can, a little bit more granularity just on kind of near term and intermediate term growth drivers. You know, can spreads go much higher in the next couple of quarters? You talked about possibly, longer term getting to 250 basis points. How long could it take to get there? And also just if you could elaborate more on growing the balance sheet and what – specifically what lending products you are focused on.

<A – Mitchell Caplan>: Absolutely. So let me tell you first of all at a high level, again, we'll give you much more detail when we go through our call in December, and we look forward to 2005. So I think that we are just not in a position yet where I'm comfortable talking about 2005 guidance. But specifically to your question at a high level, good way to think about this is do we want to grow the balance sheet? The answer to that is absolutely, if the incremental return on equity is in excess of 20%. And it's one of the things I think about on a regular and consistent basis. We are trying to get our ROEs as a company in excess of 20% across the board. So you want to make sure no single business line is a drag. So to the extent that we could continue to grow out our business on the banking side in excess of 20%, we do it. Arguably at a hypothetical level if you talk about $4.6 or $4.7 billion of cash that's sitting out there just in terms of funding the liability side - I'll address your question in a minute on the asset side - but if you just look at the liability side and you wanted to grow the bank by another $4.7 billion to accommodate that it would require somewhere around $220 to $240 million in capital. We have it. You know, it's a question of sources and uses of capital that we look at the business. I think we have remained pretty steadfast in saying that for every billion dollars in sweep we expect to see about a 5 basis point widening in spread. So if you had about $4.7 billion out there that's available and it's 5 basis points of spread widening you could see up to another 23 or 24 basis points of spread widening alone just by continuing to focus on the liability side of the balance sheet. So to your point if we exited at 213 and you are trying to grow another 23 basis points, you are talking about really being in the place that, you know, really being much closer to that 250, 240-ish range. Also when you talk about the earnings power, we've consistently said that every 10 basis points delivers somewhere around 4 cents a year in earnings. So you can see the sort of earnings power there. When you run it through you discover that there is an incremental ROE just on the liability side without any asset widening whatsoever going on in your spread of in excess of 20%. Then you look at the liability side of the balance sheet. Again, I'd prefer to talk in more detail about this in December, but arguably you can assume that we will begin to offer to our customers one integrated product, and with it comes the ability to trade, the ability to invest, the ability to have a cash management solution as we do now, and we have to make some structural changes to get that last 4.6 or 4.7 billion moved over, as well as try to grow the asset side at a wider spread by focusing on assets that are interesting to our customers, whether they are home equity lines of credit or credit cards. Obviously at a risk-adjusted return, again, that would continue to widen your spread.

<Q – Colin Clark>: Okay. And just one other question on the cost side, again to the extent you can provide any more detail. I understand, it sounds like you are going to be providing a lot more in December. But you've reduced your operating costs substantially in recent quarters. How much more cost cutting is there, and what areas? And also just on the marketing spend side, can you – that had fallen to 10 million this quarter. Can you give us a feel for the kind of level of spending in 4Q?

<A – Mitchell Caplan>: Absolutely.

<Q – Colin Clark>: And into '05? Thanks.

<A – Mitchell Caplan>: Absolutely. So as you look at the Q4, one thing I can tell you for certain is we didn't talk about it on the call, but included in the Q3 results were close to another $4 million in one-time expenses in this quarter that occurred in the brokerage segment as a result of the continued ADP conversion. So you would expect to see in the range of $3 to $4 million coming out in Q4. You know, you may not lose all of it. It may take until the end of the year, but again you would see a significant decline there as a result of that. Then as we begin to have other efficiencies associated with ADP, and I prefer to talk more about that in December as we look at '05, you'll see that coming through. But a small portion of it will also begin to move through in Q4. Given the guidance that Rob went through for next year, I think 17 to 22 cents, included in that in marketing is an up-spend of about $9 to $10 million. So it's an incremental up-spend of about 1.5 cents in the overall business in this current Q4 quarter.

<Q – Colin Clark>: Great, thank you.

<A – Mitchell Caplan>: Absolutely.

Operator: Your next question comes from the line of Richard Herr of KBW.

<Q – Richard Herr>: Hi, good afternoon, guys. I have a couple questions here. One on the average rate per trade, I think in July you had told us had increased from bottoming out around $10 to about $10.30. Looked like the quarter came right in line on that. With international trading continuing to grow, can you see that going higher? I think at the time you said between 10 and 10.50 for the rest of the year.

<A – Mitchell Caplan>: Yeah, I'm pretty comfortable with where we are right now. In other words, as you can see, we came out pretty much at the mid point. I think there are a couple of issues that are really driven predominantly by mix, obviously. So Professional DARTs were down more significantly last quarter versus overall retail. So obviously you had a mix shift there away from professional and toward retail. And then again international continues to be a very strong spot for us. So you see that continued shift within the overall retail segment becoming more focused on international. Both of those were helpful at driving where we are going. The last thing is Lou would tell you he is extremely focused on the options market and the options marketplace. Again, it carries with it a higher price point on commission, and you'll see us focused on that both in Q4, and certainly as we go into '05 of next year.

<Q – Richard Herr>: Thank you. That's helpful. And on the Softbank, can you tell us how many more gains you have to harvest there?

<A – Mitchell Caplan>: Absolutely. Softbank as of close of business today was a mark-to-market positive of about $104 million with a net gain available to us somewhere in the neighborhood of maybe $90 million.

<Q – Richard Herr>: Can you update us on the time table of your taking those gains forward?

<A – Mitchell Caplan>: I'd say prudently throughout, certainly throughout the rest of this year and into '05 and again we'll give more clarity when we talk about '05 in December.

<Q – Richard Herr>: Lastly, just on the – is your duration gap still, I think you said last quarter up 1 month. Is it still around there?

<A – Mitchell Caplan>: Yeah, it hasn't changed meaningfully. I would tell you that what's really interesting, is that if you look at the duration mismatch it was about a month and it was clearly asset sensitive. And that was true up 25, up 50, up 100. If you look at where we are right now, obviously with a little bit of a rising rate environment you've had some extension, so you may have – we've switched probably in the up 100 to being a little bit more liability sensitive. However, we are still definitively asset sensitive, up 25 and up 50 which is where we want to be.

<Q – Richard Herr>: Okay. Thank you very much.

<A – Mitchell Caplan>: Absolutely.

Operator: Your next question comes from the line of Charlotte Chamberlain of Jefferies & Company.

<Q – Charlotte Chamberlain>: Hi, guys and congratulations on a great quarter.

<A – Mitchell Caplan>: Thanks a lot.

<Q – Charlotte Chamberlain>: Two quick questions on the bank. Where would we see on the balance sheet the 800 million? Nothing pops out on there. I expected it to – I expected to see it in the bank retail deposits, but it didn't show up there. I was just wondering, where does that 800 million show up?

<A – Mitchell Caplan>: It will show up in liabilities and equity in the transactional section. So if you look you'll see a growth, a net growth of about $5 or $600 million. So if you look at transaction accounts under bank deposit portfolio you'll see the growth there. It's net up about 600. We added about 800 and lost about 200 million in high rate money markets. We continued to grow sweep accounts, which now interestingly enough we don't count them as an account. As you know, we count it as one omnibus account, but it relates back to over 1.3 million brokerage customers at this point. We also grew transactional checking account at a nice clip, and we continue to lose both CDs that are higher rate as well as the higher priced money market account.

<Q – Charlotte Chamberlain>: Okay. And the other question has to do with your consumer loans. You know, overall – and this is kind of a small – much, much smaller point. Overall the charge-offs and the provisioning looked great. But if you look year over year at are balances on the consumer account they are only up 3%. But your provision – but your charge-offs on that portfolio jumped 27% from June to September, and I was wondering – and it looks like you are buying consumer accounts? Is that what I'm seeing? I was wondering if you could give us a little clarity on that because this is the second quarter in a row that the charge-offs has exceeded the provisioning on a portfolio that doesn't seem to be growing.

<A – Mitchell Caplan>: No. In fact, if you look, our reserves are in excess of our charge-offs. There is no doubt about it. So we pretty consistently increase our reserves in excess of our charge-offs. But I think what's more important is to look at sort of where you are, as you well know from having followed us for a while, where you are in the curve of those assets that you've put on. So a year ago you would have been in a position where to your point, you were getting prepayment and you were coming down the back curve of ones that you had bought year before. In the last 12 months you have replaced and grown prepayments with new assets in the consumer finance arena, so you are now actually seeing a pickup in the charge-offs associated with those that you bought within the last 6 to 9 months. And that's exactly what's happening. Rob.

<A – Robert Simmons>: Charlotte, one other thing, I mean in terms of the question about allowance, we have – this quarter we added about 10.6 million between provision added to reserves, and then net of charge-offs of 8.7 million. So, you know, our net loan allowance from June to September grew from about, you know, 40.9 --

<Q – Charlotte Chamberlain>: No, as I said, I'm not arguing – I'm not asking about overall. I'm just talking about the consumer portfolio we seem to be provisioning less than you are charging off.

<A – Robert Simmons>: Let me just finish my point in terms of if you look at the overall, the thing that, one of the metrics that we focus on very carefully is the nonperforming loan portfolio, if you continue to look at the nonperforming loans, it's those potential charge-offs including those consumer loans, we continue to maintain very very high coverage ratio, 240% coverage as of the most recent quarter, actually up slightly from 232. So that as we've kind of seen the performance of these portfolios, which from a charge-off perspective has been exactly in line with what we've modeled, we've continued to be very prudent in the way that we've – the way we provision against those different loan classes.

<Q – Charlotte Chamberlain>: So we should expect to see higher charge-offs next quarter also on the consumer portfolio?

<A – Mitchell Caplan>: Marginally that's right.

<Q – Charlotte Chamberlain>: Okay. All right, thanks.

<A – Mitchell Caplan>: Absolutely.

Operator: Your next question comes from the line of Campbell Chaney with Sanders Morris and Harris.

<Q – Campbell Chaney>: Good afternoon. Mine kind of piggy backs off of Charlotte's question. Can you tell us the composition of the consumer loans you purchased, the $1.1 billion? And then I have one follow-up on that.

<A – Mitchell Caplan>: Absolutely. The 1.1 billion, about a billion of it was home equity lines of credit, about 100 million of it was in credit card. Of the billion in HELOCs, average FICO score was in the 735, 740 range, and on the credit card the same exact thing. So by and large one of the things that we have become more focused on is just the way in the brokerage marketplace you can grow up, go out and grow through acquisition and bring in new accounts and try and get trading volume or whatever. Can we be in a place now as we buy these home equity lines of credit and/or credit cards, do we also buy the rights, the underlying rights of the customer to be able to cross-sell them products. We did not traditionally do that. We are now beginning to do that and we intend to put that customer into our overall base and become focused on selling them other products.

<Q – Campbell Chaney>: That was my follow up, and then also the pricing, I assume the pricing on the home equity lines are prime based. Is that correct?

<A – Mitchell Caplan>: They are, and they adjust by and large almost instantaneously. Sometimes there is a notice period of as little as 36 hours or whatever, but they are pretty quick to adjust.

<Q – Campbell Chaney>: Okay. If I might, one more follow-up. On your recreational vehicle loans, can you give us an idea now that the price of oil is over $52 a barrel, can you give us an idea if there is anything, something around the edges, some deterioration around the edges in that portfolio, knowing the FICO scores are still high? Are you seeing any deterioration or is it still pretty solid?

<A – Mitchell Caplan>: We have not to date seen any deterioration whatsoever. On the other hand, to be clear, if you look at the original guidance we gave around the origination of RV's throughout the course of the year or actually both boat and RV combined out of our Gannett operation we are hitting at about 70% of plan, so we are a little off. I think part of that is the marketplace at large has become more competitive. Pricing has become more aggressive. But when you look at the demographic of the underlying borrower who is buying these, we've not seen a deterioration as a result of oil yet.

<Q – Campbell Chaney>: Thank you.

<A – Mitchell Caplan>: Sure.

Operator: Your next question comes from the line of Jed Gore with Sunova Capital. Jed, your line is open.

<Q – Jed Gore>: Thanks, guys, sorry. All my questions actually have been answered. Thank you.

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

<Q – Rich Repetto>: Yeah. Mitch and Jarrett, just one follow-up here. When you talk, and you have talked before about the ROE requirement, or the goal to achieve the 20% ROE, I'm just wondering after seeing what's happened with Schwab Capital Markets, you know, Knights results this quarter, your drop as well. Does this still – do you still view the principal – the market making business as a potentially 20% ROE business or are we going to make exceptions for vertical integration or how do you look at it now after definitely seeing the volatility in that business?

<A – Mitchell Caplan>: To be clear, let me tell you a little bit about the results that we experienced in our market making operation this past quarter. A good way to look at it is if you take the number of shares down, albeit from last quarter, you multiply it by the revenue captured, down albeit from last quarter, and you multiply that number by in excess of a 30% operating margin, I tell you it's a profitable business. When you look at the capital that's required to be put in that business, I'd trade that ROE all day long.

<Q – Rich Repetto>: So we are saying that even this quarter that we have 30% operating margins.

<A – Mitchell Caplan>: In excess of 30% operating margins in our market making operation, that's correct. I think a big part of that, as you know, is focused on 50% of the internalization and the rest on optimization. We have been disciplined about not extending into stocks we don't want to be in, staying away from the toxic flow and being very disciplined about being in our US operations where we really, really know it. So that's a big part of it. The second part of it is we had as – as variable a comp structure as you could possibly want. So you are in a place when you look at fixed versus variable in that business, you have to see a significant diminution in both revenue capture and in number of shares traded to be at a place where we weren't profitable.

<Q – Rich Repetto>: I just – I guess you got – I said this before but I guess you got to teach or give the secret sauce to the other guys as well because they are not getting it there.

<A – Mitchell Caplan>: I think a part of it is that Schwab had a totally different model based on black box technology. And so it's just a different business model and harder to make money at which is part of the reason why they looked at it and part of it was I think they wanted to return to a focus on retail as they were trying to reposition and rebuild the business. Knight has just been in a place where, you know, they are extended into a lot more stocks and in a lot more countries.

<Q – Rich Repetto>: Great.

<A – Mitchell Caplan>: A higher fixed cost structure.

<Q – Rich Repetto>: Great, Mitch, that helps. Thanks.

Operator: Thank you. And our last question comes from the line of Mike Vinciquerra with Raymond James.

<Q – Mike Vinciquerra>: Thank you. Two things. First of all, can you comment on the tax rate? I think it was down to 32.5% on a GAAP basis in the quarter and what we can expect for the fourth quarter next year? And then also the capital ratio, you know, dropped about, what, 57 basis points or so on a risk based capital basis I think your minimum for well capitalized is 10%. We're at 11.25. What are you comfortable taking that down to to have enough cushion going forward? Thank you.

<A – Mitchell Caplan>: Let me answer the second part first and then I'll turn over tax to Rob. With respect to the capital ratios, I have said repeatedly I will never ever go below, this institution will never go below and the team will never go below 5 to 10%, you know, for as long as we've operated the bank since November of 1989 we've never been in a position below well capitalized and tier 1 and risk based. Does it give us some room, absolutely. You can figure out the leverage points. Would I be comfortable going down from where we are closer to 5? I would. Would I be comfortable going below 5? Absolutely not. And the same is true on the risk base. Obviously risk base is driven by just the mix what you are buying, but we have a gating factor again of that 10% and 5%.

<A – Robert Simmons>: Mike, on the tax side, we, as you know came up this quarter to 32.5% from 31% last quarter. That was pretty much as expected. It has a lot to do with the mix of where the profits are coming in, you know, domestic versus international, and in which actual legal entities. But I think on a going forward basis for Q4, a reasonable range would be something in the neighborhood of 34 to 38.

<Q – Mike Vinciquerra>: Great. Thank you, guys.

<A – Mitchell Caplan>: Absolutely.

Mitchell Caplan, Chief Executive Officer

Thanks, everybody. We look forward to the December call for 2005.

Operator: Thank you, ladies and gentlemen. This does conclude our conference call for today. You may now disconnect.