REFINITIV STREETEVENTS

EDITED TRANSCRIPT

ETFC.OQ^J20 - E*TRADE Financial Corp. at Goldman Sachs Financial Services CEO Conference

EVENT DATE/TIME: DECEMBER 13, 2006 / 6:30PM GMT

REFINITIV

CORPORATE PARTICIPANTS

Bill Tanona *Goldman Sachs - Analyst*

Mitch Caplan *E*TRADE Financial Corporation - CEO*

PRESENTATION

Bill Tanona - *Goldman Sachs - Analyst*

Hi, I am Bill Tanona, the brokerage analyst at Goldman Sachs. Under Mitch Caplan, E*TRADE Financial has transitioned itself from an online brokerage company into a fully integrated financial services firm with many capabilities across banking and brokerage. The Company currently has about $190 billion in client assets, including $22 billion of customer deposits, ranking it as one of the largest thrifts in the country in terms of deposits.

Since Mitch took over the firm as CEO in January of 2003, the firm has nearly doubled its pretax margins, tripled its earnings per share, and its stock price has more than quadrupled. As a result of its efforts in solid execution, including recent acquisitions of Harris Direct and Brown & Co., Mitch and his team appear well-positioned to deliver strong growth across a variety of businesses and geographies.

So here to talk a little bit about their global growth initiatives is E*TRADE's CEO, Mitch Caplan.

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

Thank you, Mr. Tanona. Okay, so let's get started. So our general counsel would never let me start it without the Safe Harbor statement, so you now see the Safe Harbor statement. I want to spend a few minutes today talking about a couple different categories. The first is how we look at the business as it has evolved relative to the overall market and particularly on a global basis. It really sort of framing out contextually what we view from a global opportunity perspective. And spend some time chatting a little bit about the model, touching I guess on a bit of what Bill was describing the transformation of where we have come from to what we are today and then what it is we are trying to do. Then some of the proof points that we've experienced in that we look at internally as a team as indications or measurements of success along the way that really are proving that that transformation is underway and working. And that we are able to take advantage of it globally and then finally just close quickly with some of the growth objectives that we challenge ourselves with as a management team in order to achieve on an annual and ongoing basis.

So with that, my first slide. One of the things that is pretty interesting and I think about this on a regular basis, is who really do we want to go after and why. And how do we think about competitively positioning ourselves both domestically and internationally first against the brick-and-mortar players in the financial services marketplace, and then some of our direct competitors in what you might define as the online or alternative distribution business around financial services. And one of the things that is pretty clear is that for us we recognized many years ago that there were really three categories of financial service customers or consumers that could be targeted that we could think about.

Obviously one is at the very high-end sort of the super rich typically the fastest-growing balances, which is great, but very fast-growing balances was a limited number of people and a lot of customers that are being focused on by a very large group. So ultimately we made the decision that it wasn't a business model that made sense for us. At the same time, having come from starting a bank in the early days back in '89 and in '94 when E*TRADE went public as an online trading platform, a recognition that trying to be in the monoline service business against a particular customer segment didn't make sense.

So where we thought the most interest over the long-term would be is really with the mass affluent. And we would define that today as somewhere between 50 and 500,000 in investable assets. And what the opportunity is clearly that it is about give or take 80 million households around the globe; of those 80 million what you would find it is basically pretty evenly divided between the U.S. and international. So it is hard not to look and recognize there is an opportunity both domestically and abroad and that it represents somewhere in the neighborhood of about 12 trillion in assets, again pretty evenly split between the U.S. and international. So our challenge was to recognize that this was an interesting marketplace, it was the fastest-growing when you looked at not balances, but absolute numbers. And we also understood that for us to compete in this space, and this is the first sort of point of differentiation that when you thought about brick-and-mortar we weren't going to win against the mass affluent customer base who didn't care about value.

So the customer who basically says what matters to me is brand and distribution, I am trading that in exchange for a value proposition. That was not our customer segment and never would be. So we recognize that of those -- we were talking about it earlier today -- of those and when we first began to look at the 60 or 65 million households which has now grown to 80 million, there was only about 20% that said when you really polled them I would trade value for brick-and-mortar distribution and brand. Today it is about 35%.

So we recognize that we are playing in the subsegment of the 80 million households, that 35% that said value matters to me. But it allowed you to competitively differentiate if you can offer that value proposition against the brick-and-mortar. And it is a space where a mass affluent is growing faster than virtually any other in terms of absolute numbers and the fastest-growing segment within mass affluent are those value driven investors who are looking for a consistency and a value proposition across all products and services. So as we stepped back and thought about the strategic plan, certainly maybe in 2000 when we put the banks and the brokerage together but even more recently in '03 when as a management team we said where is the opportunity? How do we want to attack this against both the brick-and-mortar competition and then our direct competitors? Where do we think is of interest to us? So we believe as we look at the secular trends both domestically and abroad in mass affluent and in the value based solution we are playing in the right space at the right time.

Next slide. So what have we done in order to really take advantage of that? If you go back and you think about the '82 to '99 timeframe certainly for E*TRADE at that point I was running a different company. I was running Telebank. It was a monoline provider of sort of online banking products and services. And E*TRADE was doing the same thing. It was a monoline provider of direct trading services. And that was its core business. And it grew its brand, and it grew its revenue simply by focusing on those products and services. Starting in about 2000 we began to transform the brand because we bought other companies. We bought companies that allowed us to move from 2000 and 2002 out of retail and institutional where we could leverage what we were doing in retail and make extra money through the institutional relationship.

We also began to buy a bank allowing us to think about servicing a retail customer not only with trading, but also with cash alternatives as part of their investing solutions as well as credit alternatives. And then ultimately be able to offer them a broader array of other asset solutions. Finally in 2003 and 2004 I guess as a team when we really got to take responsibility for the business we said really interesting, sort of a diamond in the rough. We have the right business model. We've got the right products and services, but we have a host of back offices and we are in a place where we are as far from efficient as we could possibly be. And we needed to get to a vision to be able to execute on a platform where as you offered retail customers globally a host of products around trading and investing and cash and credit, you could do it on an integrated technology platform. An integrated operations platform and an integrated service platform.

So in that '03 '04 timeframe we worked on trying to get the infrastructure in a place where it was much more efficient and it was much more scalable and you would begin to become agnostic as to whether the next transaction in our financial engine came from retail or institutional, whether it came domestically or internationally or whether it came across a trade or a dollar of assets or a dollar of credit or a dollar of cash. And in '05 we finally got to a place where we had pieced together not only the front of the house around the products and launching things like E*TRADE Complete which really was going to lead with asset generation to that mass affluent customer. But also be able to do it in a way in which we had a very efficient back office. And as Bill said it is when we got to the point where our op margins had moved from the '20s to the mid-40s, where we were at a place where we were growing revenue at a very rapid clip and we were growing earnings at a correspondingly rapid clip. And then finally as we think about this year and beyond, it is to take what we've learned domestically and scale it as quickly as possible, and take that scale and extend it globally outside of the U.S. operation where we are currently in Europe and Asia. We are investing slowly in some of the emerging markets, but we want to be able to offer the model outside the U.S. that looks very much like inside the U.S. where you're not just attacking trading but you're going after an asset gathering customer. You are bringing in that asset relationship and monetizing it through not only trading behavior, but as or more importantly, assets, cash and credit.

Next slide. So really quickly and I think I have talked to this a great deal already, the vision for us has been to focus exclusively on the global retail customer at the center of everything we do. Monetize the relationship through those four key points; investing, which is really asset driven shows up in other revenue around asset fees and asset management fees. Trading shows up in retail commissions, the cash or banking relationship with products in the form of deposit products and credit or lending relationships and managing those retail relationships around cash and deposits and credit on a balance sheet to deliver a superior return.

And then you do that with a wrapper around capital markets that is the institutional business, a big part of it is the balance sheet management. They are the ones who take the cash and the credit from the retail customers, put it on balance sheet and manage it through both credit risk and interest rate risk. And ultimately try to figure out the most effective return on invested capital for shareholders being driven by that engagement from the retail customer. And as well we have a small institutional equities business making markets or doing global execution and settlement which is a logical extension of creating value that comes out of the retail order flow from trading. And then wrapped around entirely the global retail and then the institutional or capital markets business, is one integrated back office for tech, ops, service and marketing.

So as I have talked about what is it we are trying to do, where are we trying to go strategically, how do we think about ourselves in the marketplace from a competitive point of differentiation? When we think about the brick-and-mortar guys it is pretty clear that frankly we, as well as Schwab and Fidelity and TD Ameritrade and others are benefiting from this transformation which is occurring in the marketplace. Four or five years ago you would often see market share gains being fought out among the direct competitors. Today you actually see almost all of us benefiting from market share gains from three real big changes.

The first is the large bulge bracket firms are actually pushing a lot of what they view as their less valuable customers out the door. We are benefiting from that and so we are seeing growth there from the Merrils and the Morgan Stanleys and the Smith Barneys and the UBSs of the world. We are also benefiting from basically inheritance and generational transfer of wealth. Where people suddenly come into money and are trying to decide how to manage it. And the third is just the absolute growth; people who in their late 20s to their early 40s who are for the first time building wealth and faced with a decision about how to deal with managing that wealth and building more value for their family.

So as long as we keep our cost structure low it enables us to be able to have a value proposition that is significantly different than the traditional player in the marketplace as it relates to price and functionality and service. When you think about the next competitive point of differentiation, for us it is to be in a place where we could offer our retail customers globally against some of our direct competitors, a host of products. So rather than focusing just on trading or just on assets, we could be in a place where we offer them the opportunity based on what was happening at macro economically a product in cash if that was of interest, a product of credit if that was an interest, a trading product or an asset based product. And we could do it with a low enough infrastructure cost that we could move directionally to have a 50% out margin.

So if you can keep your cost low enough it puts you in a place where against some of the still monoline providers who directly compete with us you are competitively differentiated. And if you do it with a low enough cost structure you can be competitively differentiated against the other guys because at the end of the day your cost structure is so low that you can be in a place were even at a 50 or 25,000 point of entry in terms of asset size, you can generate a great value proposition for that retail customer and a 20% return on invested capital for a shareholder. So you have kept your costs low and contained, and that is really how we think about the business model in the marketplace today. And then we want to leverage it again as a point of differentiation through both international growth as well as our corporate services business which for us becomes a feeder. Where we have dominant market share today in stock plan administration, software, employee stock purchase plan, we use that as an access point to get into the Corporation. I think again we've got dominant market share with most of the S&P 500 companies, and then you ultimately use it as a way to interact with the employee as a feeder for growth in the core retail global business.

So in trying to do that one of the questions we get asked on a regular basis and I guess a big learning experience for me and for the team is how do you think about service and how do you think about the service spectrum in providing that to the customer. And certainly in the early days of whether it was the banker, the broker before the businesses started to consolidate, we were all really executing on a business model where in many respects you really thought more about the soloist. And you tried to deal with that soloist, whether it was on the website or to some degree in a call center.

As we have transformed our model, we have recognized that we have to think about services a broader spectrum. And so on one end it's got the website and you think about the functionality and the self-help and the intuitiveness of the website, it really is your storefront for your business to the call center. And really beginning to improve that; it's one of the things that was a big agenda for us this current year in '06 was to improve service and we did it really through the acquisitions of Harrison Brown and a $40 million investment. To be in a place where we really moved up our service platform within that area of call center.

Then you move to relationship managers, whether they are on the phone or whether they are in a branch, and then finally to a much lesser degree, advisers. And owning a series of advisers. And the goal for us and what we constantly are trying to better understand is the behavior and what we've seen is that when you begin to self-select within mass affluent, and those customers who care about values, that 35%, typically their behavior characteristics are no longer totally soloist. They are more validators. They're looking for ways to get assurance but they are clearly not delegators. And so if somebody with 50,000 in assets they want to interact with us 80% of the time either on the website or through the phone and only 20% of the time through an RM or through an adviser, you might find that somebody with 500,000 or 1 million may want to do 30 or 35% of the time with an adviser or in person whereas the balance of the time it really is the website. But the idea has been for us to empower our employees whether they are advisers, RMs, on the phone or otherwise with technology to be able to service the customer in a cost-effective way and be able to have a range of service options.

So the growth trends, I mean for us this is the most important slide even three, four years ago as we were building out the plan as a new management team for the first time and going to the board. And it became pretty clear that what you would also see which actually you're not seeing here is that if we wanted to be a long-term sustainable growth franchise and all we did was focus on trading we were going to cap out in about three years. Because there was just a limited universe of active traders both domestically and internationally and you could not ever generate a sustainable market share to be able to grow topline revenue and bottom line profits year-over-year at a level at which it made sense.

So then as we began to think about the business we said okay let's look at what really gets generated from a main street customer, from a mass affluent customer and how do we think about a target customer. And that target customer is typically mass affluent plus has some more transactional engagement, generating a little bit of revenue and profit. So for us as we think about it and as we've begun to target the right segment and recognizing that not all accounts are created equal, we may have in this year a 5 or a 6% organic growth rate in core customers across the board. But in that segment that we are really focused on which is generating over $2200, we have been able to grow at about a 30% rate.

So again, it is by taking the discipline of saying here is the mass affluent customer within it, here is the customer that we think has value using targeted marketing, as well as service through relationship managers and otherwise to be able to engage and grow the relationship with that customer.

So one of the challenges for us as a team is what are the proof points? How do we know we are doing the right things? So we've begun and I expect it will continue to evolve, tomorrow as we talk about guidance and beyond, as we continue to build the franchise what are some of the proof points of the success of the model? So when you look at it, as I was saying, it isn't about growth and accounts. Unfortunately in the early days for many of the people in our business and in our sector market caps were driven by just absolute growth. And they were driven by absolute growth in accounts, and you ultimately learn that not all accounts are created equally. And you are much more effective if you spend your dollars in a targeted way to grow those customers that make sense and to improve the quality of the account.

So whether you look at assets per account, cash in terms of the deposits, if you look at in terms of credit, net revenue, the segment income -- all of them have grown fairly dramatically over these last couple of years as a result of being much more disciplined about focusing on the right customer. And engaging them in ways in which we generate revenue and profit across a host of touch points involving the cash, the credit and trading in the assets.

One of the things you can see and it is sort of a logical extension of the prior slide is how has the business model changed? So as we have grown the business we have moved from a place where what really frightened me probably the most in '99 and 2000 when we were first announcing the deal of selling the bank to the brokerage was, it was 70 to 75% of the revenue streams being driven at the brokerage were all-around retail trading commissions. And so you really were much more subject to the vagaries of what was happening in the equities marketplace.

As we have begun to build out the model and recognize that we don't want to run ourselves as a brokerage or a bank, we want to run ourselves as a global company that focuses on that retail mass affluent customer. We want to have integrated back offices so it is why we have recently put together the brokerage in the bank, we have actually moved our brokerage business under our bank to run one enterprise consolidated operation.

So you're in a place where when you think about your ops, your tech, your service it is a logical extension of all of the products and services that you are offering to that retail customer. We have correspondingly been able to dramatically transform the revenue streams that are coming so we are now at a place today where I guess retail commissions are about 18, 19% of total revenue. Total commissions including institutional are maybe 25% give or take 50, 55% comes from net interest income driven by cash and credit of a customer and the customer relationship, and the balance really comes in fees. So and that is a business model that we like and we like that balance and the mix and the goal is to keep that as a mix, and just try to grow it dramatically by continuing to engage with the customer.

So while you're doing that it is important to understand how your revenue streams are changing, how you are able to grow revenue at a rate that is satisfactory to be a growth company but at the same time as I was talking about earlier in '03 and '04 you have to make sure you control your costs. And you do it in a way in which you can widen your op margins as a result of being more efficient. So you can see that we've now gone from -- and if you've gone back to '03 it would have been in the '20s -- we've gone from in the 20s in terms of op margins to the mid-40s and again our stated goal is to get to about a 50% operating margin. We've done it simply by growing through scale and efficiency, and it isn't scale and efficiency with a monoline product, but rather it is truly becoming agnostic as to the next financial transaction. Because you have effectively created a manufacturing plant for financial services, and you're moving the products and services through the back office.

So what are a couple of other key points for us that matter and that we think about on a regular basis? There is no doubt that our business model is unique from some of our competitors because embedded in it is in fact a growing balance sheet. And so one of the things that we have to think about is the mix, so what percentage of our liabilities come in the form of pure customer cash as opposed to wholesale borrowings? What percentage of our assets come from loans from customer as opposed to securities? And moving directionally where we want to go.

The second piece of that is how do we think about the growth in a balance sheet and leading to the growth in net interest income and other points of engagement that come out of that relationship. So as a customer engages with us around cash and makes decisions about what product is of interest to them on the cash side or on the credit side, and it drives an implicit spread. What are the other behavior characteristics around trading our assets that are also occurring with that customer to drive corresponding revenue? And how do we do it in a way in which we control both credit and interest rate risk?

So you can see that net interest income for us has grown on an absolute basis and also on a percentage basis, and the ways in which we think about it is to move directionally. And I think the next slide shows you that the goal would be to be in a couple years ago we were sort of 50% or in the '50s for deposits or enterprise cash as a percentage of liability and the same with loans. Now we're sort of in the mid '60s; the goal as we move into next year and beyond is to be in the '70s and 75 and ultimately I would love to see us at about 80% in terms of the mix shift. So what is really driving the balance sheet is that engagement with the retail customer around a host of cash and deposit products as well as a host of credit products driven entirely by margin and mortgage. So firstly mortgages, second mortgages and home equity lines of credit as well as margin balances.

Again, the goal is to do this and one of the things that is interesting is we have not changed our philosophy literally since we started the bank, since I started it in '89 around credit. We have always been and I believe at least for our model its the right way to think about it, a business I would rather be more leveraged and hold between 5 and 6% Tier 1 capital and be more leveraged and take virtually no credit risk. So we have therefore focused almost exclusively on mortgage and margin loans. Within mortgage loans we focused exclusively on what you would define almost as super prime. So whether you look at average, median or mode across the board they are in the mid 700,720,730 range, across all the products and services. LTVs are probably way below what are typically industry averages. You can see where it is 68 or 69% and first lien positions were in the mid 70, 76, 77% -- it is a little high there compared to where we are running now in home equities.

And then finally the only other way I know to control credit is to make sure that you look at geographic diversification and you look at concentration not even by state but by MSA. And one of the nice things and one of the interesting things why I wanted to sell the bank to the brokerages, from the early days at looking at the customer base I knew it was high FICO score and I knew they were geographically diverse across the entire United States. And they were customers who because they wanted value would trade a better value product for a tighter loan to value. And ultimately it was the right mix and the right reason to put the two businesses together.

So as you think about everything that we've done successfully, the goal on a domestic basis, the goal is to then move that outside of the U.S. So one of the things we've had to do is take a business where in certainly '02 and even as recently as '03 it was losing significant amounts of money.

At our [work] peak we lost about $60 million a year annually internationally to a part of the business that would first get to breakeven and now be profitable. This current year that we are just ending we will be about 8% of revenue will come from international operations, and a little less than that will come in terms of EPS. Because the margins aren't as strong as they are elsewhere but they are rapidly improving as we begin to build scale across the company. And while we have been able to cut costs internationally by focusing on one product which was trading, we were able to have very strong growth rates.

You can see when you look at trades the CAGR in the last three years internationally has been 30% or growing at 10% or more per year. It has been very, very strong growth rates versus what you're seeing in the U.S. So we have had outpaced growth internationally around the credit around trading and now the goal for us certainly as we enter '07 we will -- we have filed for and will be receiving approval we hope shortly for a banking license in the UK. We will use that as a means to passport into all the other EU countries and begin to extend the business model that we've been successful with domestically, first in Europe through all the EU countries. We are looking at the opportunities in Asia and ultimately over time, we will look to see what we can do in the emerging markets. Both India where we have currently made an investment and we hope in early January we will have control of a company there by the name of IL&FS Investsmart, as well as over the longer-term looking at the opportunities in China.

So finally in closing I would say this, what are the financial objectives that we've talked about for a long time? Where do we want hold ourselves accountable to? And that is pretty consistently growing topline revenue by at least 10 to 15% a year. So when you look at whatever you conclude one year with in terms of overall growth in revenue you want to make sure that the next year as you think about that mix coming 20% or so from trading commissions, and about 50% or so coming from net interest income, and a balance coming from maybe 5% from the institutional and the balance coming from fees around assets and asset gathering. To be able to keep that mix and just grow revenue by the 10 to 15%. Grow income both segment and bottom line, so take your GAAP EPS number and grow it every year by 20% or more. That would be the goal as we think about our business. And then finally do that while approaching and surpassing and op margin of about 50% on an annualized basis. So with that, let's turn it over to questions.

QUESTIONS AND ANSWERS

Bill Tanona - *Goldman Sachs - Analyst*

Mitch, I am sure you are probably sick and tired of answering this question, we had Banc of America here earlier this morning and talking about how successful their offering was even though they didn't quantify it. How do you think about the threat from the Banc of America's offering free trading, and how do you think about their offering in terms of 25,000 and if they were to go down to 10,000 and zero eventually? Have you seen any threat from Banc of America as a result of that?

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

I don't know -- you may have known this from talking to Townsend, but so Adam was with me and we were concluding an around the world trip. And we had spent a week in China, and we had worked with some of the folks in China in terms of potential partnerships, and then we went on and we had announced the tender offer to take control in India. So we spent about a week in the Indian operations and then we were concluding in Milan to have a discussion with somebody in Milan and we were also getting ready to open our office in Milan. And we landed in Milan, we flew through the night from Mumbai, and we got to Milan and somebody gave me a heads up that this was coming. It was an article in the Wall Street Journal. So after they resuscitated me I waited until 5:00 or 5:30 in the morning and called Jarrett and said, the problem is I hear one piece but I have no idea what the offer is. So like as fast as you can get this information, try to get back to me on what you think this is. And Townsend was with me and he was trying to (indiscernible) people it was impossible to understand.

So I would tell you it was a couple hours of relative stress and intensity, and then as it came back to me what the offer was, which was "free trading" as long as you moved over $25,000 in cash at 50 basis points. I thought I'd do that trade all day long. As a business model. And I was pretty confident from the early moment that this was going to have zero impact on our business, and it has in fact. I think we even have some stats to talk about it tomorrow on the call but we have had -- I don't know lost one account. It is de minimus. We had zero impact on our business.

So the first thing I worried about once I got calm and realized it wasn't a competitive threat from BofA and that in fact what they were trying to do was grow deposits. What they need to do to build out their business model and I get it, within their retail consumer franchise is to have growth in very low-cost deposit products. And they needed to figure out since they had basically been permitted to buy as many as they had and the regulators put the kibosh on buying any more, they needed to figure out what was an interesting way to grow low-cost deposits. And so my thesis and so far it is bearing itself out was that it was going to be if successful, they were going to gain share and not from us and not from our direct competitors but from the banks.

And so the thing that I had to worry about wasn't that it was a competitive threat but how some of our direct competitors would react. And would Joe or would Chuck or would Bob Reynolds, anybody do something as a knee-jerk reaction. And so the sigh of relief I guess that I sort of breathed is that in very short order each of us started saying to the marketplace, since we can't talk to each other, that we didn't actually think it was our customer. And that wasn't who we thought the BofA was going after and so we had little intention to respond in any way. So I guess as it has continued now for three or four months, whatever it has been, I've had the occasion to speak with Chuck and Moglia and everybody else, and all of us are saying the same things, which is so far we've seen adversely no impact.

And the reason why I believe that to be the case certainly for our business model, is I recognize that I wish more than anything that we had 80 million households that we could go after. I recognize that of those 80 million households that are in our target segment as mass affluent we can only target those where they are willing to swap out value for brand and distribution, meaning brick-and-mortar. And so you still have -- we've got about 35% of those are our target market -- you still have 65% of people out there who say it is more important to me to identify with a big brand name and lots of brick-and-mortar distribution. Those are the customers that BofA is going after. They are going after people who say I am perfectly satisfied with the rate that is being paid to me by my brick-and-mortar bank as long as I can walk down the street and see lots of branches and I understand what is being provided to me.

And de facto somebody who comes to E*TRADE is smart enough and understands the value equation. They are coming to us because -- and I recognize this (indiscernible) it is why the most important thing for our business model is keeping our cost contained. Because in order to be successful we have to have a low enough cost infrastructure to be able to give value to the customer consistently in product and value to the shareholder in terms of an economic return. And anybody who comes to E*TRADE is coming because they are saying I want value. Now price matters. The good news is when it was Telebank or it was E*TRADE as a monoline trading Company I thought we had to be in the top 1% but we could never drop to the 50th percentile in terms of pricing, ever. It wouldn't work, so we're probably competitively positioned in the 20th or 25th percentile. The top 20 or 25.

And ultimately as long as that is the customer we're trying to go after and we believe that market is big and growing they are going to be interested in us because of the value proposition. And what BofA would have to do it isn't dropping the balances. It is changing the rate structure. If they woke up tomorrow the things that would worry me is if they woke up and said, we are not going to pay 50 basis points, we're going to pay 350 or 400 basis points on that same product. Or if they woke up and said we're going to spend $3 billion or $2.5 billion on building a trading infrastructure platform to actively compete with Fidelity and Schwab and E*TRADE and we are going to offer it for free, which intuitively seems less than likely.

Unidentified Audience Member

You highlighted the cost structure earlier and then you just mentioned again in response to that last question. Could you describe how you maintain that low cost structure? What are the key elements, and is it -- where it is going to be, or is it improving even still from here?

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

First of all, it better still improve. We are at a -- what did we say last year -- this current year 43, 44 and the goal is to get to 50. Part of it is it will be growth in revenue. One of the things that is interesting is right now as you look at our current business model our incremental op margins on the next dollar of revenue across the whole company are about 73%. So as we continue to grow revenue we're growing it at a higher incremental op margin moving us directionally where we need to be. A subset of that I would tell you is that it is technology. And it is consistently trying to use technology as a point of leverage. So a good way to measure that and think about it, whether it is against brick-and-mortar companies or even some of our direct competitors, our comp and benefits to revenue runs some 20% now. And so what you're effectively saying is I still want to offer the products and services. I want to offer the service channels, but I want to do it in a way in which I am still embedding technology as the primary driver so where possible, you're constantly using text to replace people and replace physical locations.

And it keeps in a place where you have a much lower cost structure. And what is interesting about that is when I started the bank in '89 that was sort of the business model in the banking world and we did it. We ran it at 65 or 70% less cost than typical brick-and-mortar branch infrastructure. When you look at E*TRADE in its early days it was a lot of what it was trying to do. And together we have just been in a place where as we've grown the business we've been able to get more scale and we've been able to do it by continuing to leverage technology.

Unidentified Audience Member

What kind of success have you enjoyed in keeping the Brown client? They look a little different than your target market that you were talking about.

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

So one of the things that is great is that we actually stopped updating, but we did both Harris and Brown, so we did Harris Direct a little bit before we did Brown & Co. In both of the deals we assumed we would have about 15% economic attrition, and that 15% would be on an annualized basis and would occur in the calendar year of 2006. Even recently with the last time we report and this hasn't changed in any meaningful way, I think we were experiencing somewhere in the neighborhood of what was it? (multiple speakers)-- yes, it was about 9, 10 for Harris and about 5 or 6 for Brown. So we meaningfully beat on both cases our assumptions around economic attrition. And it hasn't really changed.

And what is nice is that that was just looking at it as a stand-alone against economic attrition. Then we also were able to take both Harris and Brown customers and actually cross sell them products which we never built into the original model. So this year by way of example we've had a very strong growth in customer cash. Last quarter we had in Q3 we were up about $1.4 billion. I think in Q1 it was about $1.6 billion. This quarter we are in a decently strong rate of growth around cash. And through Q3 and just in this calendar year, we had been able to cross-sell of the growth in customer cash a little over $1 billion, like it $1.1 billion or $1.2 billion came just from Harris and Brown customers.

Unidentified Audience Member

Your (indiscernible) are in the RIA custodian business. I was wondering if you looked at that or if that's an opportunity in the future.

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

We have, and I think it is unlikely, to be honest with you. I think we think that the more interesting opportunity for us given where we already are and competitively positioned is our corporate services business. So for us the way they think, I think about RIA and custodial, we think about the same opportunity with corporate services.

So we've got a relationship with, again dominant market share of the S&P 500. Ultimately, we are providing through our businesses which were shared data and options link, and today we call it E*TRADE Corporate Services. Stock plan administration, execution, software, as well as the [SPP]. We use that as a way to get into that corporation and in fact, often when we make a decision about where to buy an adviser or where to put a branch, we look at how many corporate services relationships are within 20 miles in or around where that physical presence may be in order to be able to use that as a link to leverage the relationship with that employee.

Unidentified Audience Member

How is the success then of the corporate business in terms of retaining those clients who exercise options and retaining the assets?

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

So historically -- put some context around it in 10 seconds or less -- when we bought the companies, we bought them in, what, in '97. And I guess the theory with [Crutchtouch] and others was that we were in an execution business around trading, so why not buy a company that was in corporate services were people would exercise options and we would generate revenue every time they exercised an option. So perhaps not the best sounded theory but ultimately over the long-term it has turned out to be very fortuitous because what we came to realize is that the value isn't in selling the software. The value isn't in the HR relationship. The value isn't in the maintenance contracts. The value is in the underlying employee and the retail relationship. And the greater value in my opinion is that they exercised the option, forget the $15 or whatever that you make on them, the real value is they now we are sitting in cash. And they are going to take that cash and make investment decisions or they are going to take that cash and buy a house or do something with it and borrow.

And so how is it that we can both retain the cash deposits in the form of cash or other forms of assets or help them with a credit relationship if that's what we are interested in. And we have gone from a place where literally three or four years ago people would exercise and within 6 to 9 months we had retained somewhere between 0 and 1% to a much higher number on a percentage basis. And I think we will probably spend more time talking about that tomorrow.

Unidentified Audience Member

Can you update us on your criteria for acquisitions, return on equity, dilution, earnings accretion? What historically have you told everyone and what are your thoughts on acquisitions from a return perspective?

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

Thank you, Michael. I think as we've looked at the market -- look, a perfect example would be we loved the economics initially when announced, and they have gotten even better around Brown. I mean Harris Direct, sorry. Then you looked at Brown and the issue was it didn't seem as accretive. Now if you looked at it in a vacuum people would have been ecstatic. When you looked at it compared to where Harris was it was less accretive. Why? Because with Harris we chose to pay for all of it in cash and used debt which is more cost-effective than using equity. So ultimately when we looked at the -- I ended up looking at the two of them in tandem. And said, okay, here is the total purchase price, here is the level of accretion we are getting, here is how much we are funded with debt, here is how much we are funding with equity and how does it make sense. So that is a perfect example of trying to balance the opportunities in the marketplace.

But by and large I think what we have said is that -- I cannot think it -- you should never say never, but unlikely that we would ever do a deal that wasn't accretive currently. And unlikely that we wouldn't do a deal -- that we would do a deal that wasn't in my opinion sort of reasonably accretive. And so the range of accretion for Harris and Brown on a combined basis was about 15%, somewhere in that range to earnings. And what we learned from Harris and Brown that was incredibly interesting was we weren't buying in the online brokerage space. We were actually buying mass affluent customers. In both cases. And in connection with buying those kind of customers, they came with some trading behavior, but they came with significant assets, they came with cash balances and they came with credit balances in the form of margin.

So in both cases we eliminated whether it was theirs or ours, about 85% or so of the cost structure, and then we took the behavior of those customers around cash and credit and trading and assets and monetized it in our business model. And so it drove pretty significant value. So as we think about opportunities for consolidation -- I think my job is to say okay is there an opportunity to do something with Schwab or Fidelity or PD Ameritrade, but is there also an opportunity to do something outside of the U.S. internationally? Is there an opportunity to do something outside of what you would define as online brokerage or even online investing in ways in which you do exactly that; you are getting growth in customers, you are getting growth in mass affluent customers, you are getting a series of products and you can take the vast majority of the cost out. So that you can hit those hurdle rates. And ultimately the goal would be to continue to help move us in a 50% op margin and also be at a place where we are generating in excess of a 21% return on invested capital.

Unidentified Audience Member

I'm not looking for you to disparage your competitors, but when you listen to Ameritrade, they describe themselves in a way not terribly dissimilar in terms of its goals and its focus, particularly in the post TD merger environment. So could you describe how you look at that? Are you both able to be successful in parallel pursuing the same target market, or does it have to be sort of one or the other?

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

First of all, I'm not going to disparage them because Joe does a great job. And when I look at the size of the marketplace what I try to validate all the time is, are the trendlines moving in the right direction for all of us? Do I believe there is more mass affluent tomorrow then today? And do I believe more of them want value? Which is really going to be sort of the DNA or the key components for any of us to be successful. And so given that we are all moving in a direction where we are becoming more profitable and our op margins are improving and whatever there is obviously room. Do I believe there should be consolidation? Yes, I do. Over time I think it is the right thing to do, but as we each build out our business models today the way in which I try to think about a point of differentiation, for example again Schwab and Fidelity is that their -- and it is not disparaging, it is just a different business model -- their cost structure is much higher.

They have comp and benefits to revenue at much higher numbers. Their overall infrastructure costs are higher which means that it is tougher for them to be able to offer the same value proposition and get a 20% return for shareholders. When I think about Ameritrade their cost structure is great. What they don't have yet is they can't really monetize the value of a customer relationship with a customer around cash and margins if they are not managing it on balance sheet. It is getting managed externally through the TD relationship. So there is only so much value they can get through that because TD just can't give it because they are going to get criticized by the regulators in terms of arm's length transaction in terms of the value.

So we believe that as we think about our business model we can just generate a superior return as a result of controlled credit risk, controlled interest rate risk and managing the cash and credit on a balance sheet. The other piece against Schwab, Fidelity, TD Ameritrade is -- and listen we could've gone the other way -- but we made a bet in '03 that the right thing to do was to turn international from loss making to profitable, and that we could do that in reasonably short order. Most of our direct competitors were faced with some -- all the same economic situations that we were in terms of declining revenue, and so although them withdrew from the international opportunity. And for me I am delighted that we didn't because I still see it as a big area of growth over the long-term.

Unidentified Audience Member

Is there at all a concern on your part that at some point sort of the great liquidity, great prosperity we're experiencing globally was interrupted that that might have an influence on the proportion of people that want to be validators? Or have you lived long enough through this that that is just an inexorable trend and it would be a blab or a bump in the road sort of?

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

It's a great question, and what we have seen todate -- and again, I was talking about it earlier with Sally -- you have to look at trend. I started with the bank in '89 and I frankly haven't seen an uptrend. But at least I been doing it for 16 or 17 years and watched some of the trends of credit and interest rate and behavior of customers. So when you step back and you think about the customer behavior what we are seeing with respect to the kind of mass affluent customer that we are engaging, is that there is -- and the analogy that I give, I give a great analogy that we talk about internally and in terms of our team is that many years ago when the Internet models were all afire, everybody thought -- everybody was a soloist and that was going to be sole solution and it was going to cure cancer and it was the solution to everything. And you recognize that just like brick-and-mortar branches, they are here to stay both in the investing world and in the banking world.

But if the trendlines are moving in your favor that is a good thing. And when you look at the behavior there is probably less of a demand for sort of that pure soloist that selling still exists and one way to think about the soloist is that they get in the front seat of the Volkswagen and they drive off. The delegater gets in the back of the limousine, and the partition goes up and they get driven off. And someone is just making the decisions. What seems to be the most interesting is can you build a business model where you let the person get behind the wheel of the car but there is a GPS and you become the GPS. So you become sort of the navigation controls for them and some of those can be done online and some of them can be done off-line. But if you can mix the two effectively you can keep your costs low enough. So you are in a place where you can give advice and you can give that validating advice that people want and even to the extent that they want some pure controlled advice discretionary, then you can still provide it as long as the underlying theme there is it is not 100%, and you are using technology as a way to create efficiencies in the business models. And today that it what we have seen as the opportunity.

Unidentified Audience Member

You said you've identified a segment within the mass affluent market. I'm just curious you said they were more transactional. How big is the segment within the mass affluent? Is this 10%, 50%, 80%?

Mitch Caplan - *E*TRADE Financial Corporation - CEO*

It is much smaller. The ideal is eventually you will move more to the norm of that chart, so if you look at $100 versus whatever it was, 16 or 17 versus 2200, the reason why we are at 2200 is because a portion of our mass affluent customers are more active transactionally. On the other hand its a limited universe. There is no doubt about that is why I didn't want to build a monoline trading business. Because you just, there is just not enough available customers either domestically or internationally to be able to -- if your goal is in concluding if you goal is you want to build revenue at 10 or 15% a year organically, not through consolidation but organically, and bottom line EPS 15, 20% or more every year, you can't do that if you're going to focus just on the trading or the actively transacting. Because there is just not enough of them.

But the good news for us is we have continued to gain market share in that space. It has been an important part of our business model within the overall mass affluent, i.e. some trade frequently, some trade infrequently, and within that it has allowed us to generate a more superior return then you might see in just the straight mass affluent customer.

Thanks a lot.
