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ETFC.OQ^J20 - E*TRADE Financial Corp. at Sanford C. Bernstein & Co. Strategic Decisions Conference

EVENT DATE/TIME: JUNE 02, 2005 / 12:00PM GMT

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PRESENTATION

Brad Hintz - *Sanford Bernstein - Analyst*

I am Brad Hintz, the brokerage analyst at Bernstein. This morning Bernstein welcomes E*TRADE Financial and Mitch Caplan, its CEO, to the conference. The online brokers are a fascinating sector, as I think you all know, that are caught in what appears to be an unending price war between Fidelity, Schwab, Ameritrade, E*TRADE, and now, surprisingly, Wells Fargo. The group continues to wait for the retail investor to come back to the market. As I think all of you know, the last time we had a retail downturn was after the crash of 1987. It took four years for the retail investor to come back to the market. So, we're still waiting for mom and pop to get back to the same levels that they were in 2001, and we are at four years. We've had a couple of recoveries since then in a few fits and starts, and we're going into a summer slowdown in terms of the activity. And of course, we have the normal thing that happens in a summer slowdown; all the hedge funds short the online brokers at this point. But E*TRADE is a little unlike the other online brokers. And it is famous for the fact that it built a credible banking business to offset the volatility of its brokerage business. And this has been really a remarkably successful strategy and you've seen a number of people copy this one. It has reduced their client account turnover. It has added a stable base of earnings to the Company and a stable base of net interest. Now, the subject this morning of course is consolidation. And we have with the stocks a number of rumors of consolidations sweeping around them. This should be a very timely and interesting presentation. We hope that they don't have to file an 8-K like JPM did yesterday. With this, as Joe Ripitz (ph) would say, it is your move.

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

Thanks, Brad. Good morning, everybody. We begin all of our presentations as our General Counsel would insist with our Safe Harbor Statement. Let me take a minute and spend some time describing, as Brad was saying, a little bit of who we are and the journey we have been on over these last certainly 20 years since Bill Porter founded E*TRADE as Trade Plus.

We started out literally being a monoline company in that we offered trading solutions by leveraging technology, having a lower-cost platform and creating a unique value proposition to customers. And as Brad was saying a moment ago, the business has evolved very dramatically on this journey over these last 20 years, where today, if you look at sort of who we are, clearly at the core of everything we do we have got our global retail customer. And we are providing to that retail customer, certainly in the U.S. and now as we are expanding much more successfully internationally, solutions around investing, for which we are well known, trading, as well as now assets in terms of mutual funds, ETS and other asset-gathering products.

We are also providing them cash management. Simply by having a bank's balance sheet, we're in a place where we can give them FDIC-insured deposit products that are linked to their retail investing accounts. So, it becomes a point of differentiation and significantly greater value and finding (ph) lending products. You again start with this core global retail customer, but it allows you to establish multiple points of revenue off of that retail relationship. So, you're not as reliant simply on trading or trading behavior, or even just trading and investing. But, as customers' behavior changes based on what is happening in the marketplace and they move in and out of cash, we can take advantage of that. And as we strengthen their lending relationship with us beyond simply just offering them a margin account in a traditional investing way, but also other products like a home equity line of credit or a credit card, it also deepens the relationship and it allows us to generate multiple streams of revenue.

And around that you have an institutional business which really predominantly is the balance sheet management of the Bank, which is about $26 billion in size now. But, it really is thinking about the business as a capital markets operation, but only as it links to retail; only as you can prove to yourself consistently that there is value being driven from retail to institutional or institutional back to retail. And finally, you do it with a vision of having one wrapper. One global technology platform. One global back office and one global customer service. And by doing this, it creates scale. So, rather than looking for scale around something as monoline or monolithic as trading, it is another financial services solution. So, whether you take in a dollar of cash or another trade or a dollar of assets or a dollar of a lending relationship, you're doing it off the same global back office platform.

So what it really does at the end of the day is it allows us to create a franchise that's differentiated, certainly differentiated from the brick and mortar, where you have a lower cost infrastructure and you can differentiate the price functionality and service. And it also lets you create a differentiated franchise in the space that we're playing in online because of the depth of product and the multiple sources of revenue that you can engage with that global retail customer.

One of the things that is most interesting to us is it's terrific to have built a business model which is working. As Brad said, we're generating pretty consistent earnings growth, consistent revenue growth. And a lot of that is because we have fine-tuned the model both in the front and as it relates to the customer and on the back-end as it relates to the efficiency. But you have to take that model and meld it with the opportunity in the marketplace.

So what we're looking at and we believe is the greatest opportunity, as you see here there's about 46 million households with somewhere in the neighborhood of 50 to 500,000 in assets. They all have trading needs and have a certain percentage of trading behavior as they act day to day. They're looking to gather assets and they also have credit relationships. And by and large they have been abandoned by the brick and mortar guys, because it's very hard with their cost infrastructure to make money with somebody, certainly at the 50,000, even 250, and often as you're moving to 500. That is when they're really starting to engage and get interested on the brick and mortar side.

So, as we look at the marketplace, we believe that our target customer is really the 50 to 500. Even as we started on this journey of gathering assets a few years ago, we have been more focused on the 50 to 250, which is really the sweet spot that we see as having been abandoned and a huge opportunity for us to engage with that customer as they are trying to build wealth slowly. And we can offer them a true value proposition in all of our products that is based on price, functionality and service.

So, we talked a little bit about the evolution. Phase one was over 20 years ago. It was this concept of simply saying can we leverage technology to create a lower-cost infrastructure and then price differentiate with the product that we are offering? And that is true whether you think about E*TRADE in its original incarnation as Trade Plus, whether it's the bank which I founded is Telebank, whether it is our mortgage company, or any of our products and services; when they started initially as independent businesses, they all had that simple premise which was if you can predominantly use technology as a way to dis-intermediate cost for a delivery channel, would it put you in a better place? And the answer was clearly yes. And then the goal was to pull that together in an interesting way. So, that is Phase one.

Phase two is we began to build this model where it was diversified. So we started, as I said, with Trade Plus. We began to add on other products really by buying businesses and integrating them in, whether it was the banking side or the lending side or on the institutional side.

Phase three was simply just getting the back office organized. It was getting to this place, as I showed you in the first slide, where you had that wrapper; you were moving as close as you possibly could to a global platform that had one back office, one technology platform and one service platform.

And finally for us, phase 4 is to align these organizations to the customer segments. As we've stepped back, one of the things that we did certainly very well in these last few years was as we went through a difficult market in the latter part of 2000 and 2001 and 2002, we got hundreds and hundreds of millions of dollars of cost out of our business. And we did it actually while improving the customer experience. Because rather then creating these individual back offices and not connecting the customer experience, we have done a lot of efficiency while at the same time creating a better connection with the customer. That being said, you tended to run your business along the lines of the individual product, i.e. a bank or a brokerage.

And ultimately what we were doing was we were becoming incredibly focused on was the bank as profitable as it could be? Was it generating the appropriate return on invested capital? How did we think about the brokerage in the same way? What is it that we can do to ensure better returns for our shareholders? And we did it. But, we came to the realization toward the end of last year that as you go forward, the way to really build a franchise, now that we believe we're operating efficiently -- we're generating risk-adjusted returns that are far in excess of our hurdles; we're moving in the direction of where we want to try to go as you look at a consolidated operating margin. But, if you really over the long-term want to build a franchise, you have to think about the customer. So we have moved away from thinking about bank and brokerage to thinking about the customer as the lead generator. And so we now are running the business along the lines of retail and institutional.

If you go back as I was saying early on, everything begins and ends with this global retail customer. And the way in which we really touch that customer and generate profit is in the form of commissions, trading. Now about 20% of our total revenues comes from trading. So, we really have transformed the business from certainly its inception and even as recently as four years ago, five years ago, where 70 to 80% was commission-related; we're now all the way down to about 20%. And we're generating a significant amount of revenue outside of the traditional trading commission, yet it is still a growing number for us; it's just declining as a percentage as our overall revenue has grown into the 1.5 billion to 1.8 billion range.

Investing. We are continuing to make significant progress. Again, a couple of years ago when we were at our low, we had about 16, $17,000 in assets per retail account. We have now moved that to the high 30s -- 38, 39,000; trying to move towards 60, 70, 80,000 per account as a result of engaging more with that customer in lots of different ways. And certainly one of the lead ways in more recent years, the last six quarters, has been around cash and their cash management needs. It goes into that cash management suite product -- again, extremely profitable for us.

One of the things that we've recognized is if we have got 15,000 -- which is pretty much an average balance for us across the board -- of a customer's cash and we're managing it, that's as profitable for us as an active trader. So, it's another way in which we can connect with that customer. And as you go through the volatility of the equities market, you're still engaged and making a profit off of that customer in a way in which you're providing them value and they're providing returns back to us.

Lending -- again, around the margin. We now think about not margin necessarily as a brokerage product, but as you're thinking about retail and institutional and we think about that lending relationship, we think about how much is that customer connected to us in terms of borrowing for stocks, borrowing where their house is secured with a mortgage or a home equity line of credit? And in time, we're building a relationship with them around a debit/credit card as well, because that links into the cash management solution, and then finally fees.

So, link to institutional is, as I said earlier, you really have three connections. The first is you have got a group who manages the balance sheet of the Company. So it is no longer thinking even about the Bank's balance sheet at $26 billion, but it's thinking about the Company's balance sheet at close to 100 billion. And how do you optimize that management in a way in which it is creating leverage for you to offer better value to the retail customer and generating superior economic returns to the shareholder?

On the equity -- and that tends to be pretty fixed income. When you move over to the equity side of the business around institutional, you really have two. There's a market-making operation which is simply trying to take one of our core retail assets in the form of order flow and leverage the relationship and create higher economic returns for us. Because as we can internalize and guarantee that we give our customer best execution, we at the same time can make more profits for our own business, and then finally, our scale trading and lending business which in many respects was our real foray and the platform that we used to go international. Because if we are in the sales and trading business institutionally and it's profitable for us and it's generating good returns, then can we use that business and that platform and that location to extend into a retail presence internationally outside of the U.S.? And through that focus it's taken us from a place where literally four years ago we were losing 50 or $60 million a year around our international operations, to where we're now profitable. So we have completely turned the corner and moving in the direction of literally delivering returns internationally that are going to begin to parallel the returns in the United States. And it gives us an opportunity as we look at (indiscernible) option for growth. Because we've now -- while many of our competitors withdrew internationally, it allowed us to have a point of presence, so that when you look for example at trading solutions and we report our monthly activity, you'll see that international is becoming a significant presence and a big part of what is getting delivered there as a result of the business model.

So, as we stepped back, one of the things that we had to validate for ourselves and that was crucial to us was when you are looking at the business, is it working? Are we doing what we said? Are we averaging retail? Are we getting the value from institutional? So, clearly, the best example internally for us, and the thing that gave us the comfort to move away from bank and brokerage and begin to think about retail and institutional, was our cash product and our SWEEP account. And the reason that is the case is people would often say to me the Bank is doing very well. The point is the Bank was doing very well because cash was growing in a "retail" brokerage customer account. And we were able to offer unique functionality around that cash account and we also offered better service based on the level of engagement in that customer and a value proposition with returner (ph) rate.

And it was something where it was symbiotic; you were taking again that retail relationship with an investing customer and you were leveraging it on the Bank's balance sheet. And as we stepped back we recognized is we swept over about $6.2 billion and growing in cash that was sitting on the balance sheet of the whole company and put it onto the Bank's balance sheet; it has generated for us in the neighborhood of about -- really in excess of about $200 million in pre-tax. So, it has been significant improvement to our economic returns while at the same time giving back to the customer. And that was really the proof point for us that we had to not think about the business as bank and brokerage, but to think about it as retail and then institutional.

At the same time, as you look at operational efficiency, as I was describing -- certainly in these last two years, but I think the slide goes to the last year -- in 2004 we dropped 148% of the revenue growth to the bottom line. So, as we grew revenue we grew it, obviously, at a significantly higher operating margin. And you'll see in the next slide or two we have grown our op margin now to in excess of about 32% consolidated. And as we've stated publicly, our goal is to get to about a 40% offering margin as a consolidated business.

One of the nicest things for us, certainly as you look back over these last couple of years is I would have stood up here three or four years ago and the questions for me and for our company was -- what do you think about your balance sheet? Are you worried about your cash burn? How can you have access to capital? How can you grow your business? And as we became significantly more efficient on the back-end and we were growing those multiple touch points around revenue with customers on the front-end, we started really becoming significantly more profitable. We have turned the corner and we're now generating significant amounts of free cash. In connection with our guidance this year of 93 to $1.08, we will generate anywhere from 6, $700 million worth of cash. So the goal for us is to take this cash -- we're starting right now with a balance of about $690 million of free cash at the end of last quarter -- what is the best way to deploy that to generate returns for our customers?

So, you can think about the whole range of them. And we have looked and used all of them. We have over time retired debt, a significant amount of debt. We have also restructured the balance sheet. We've gone to a place where at one point our debt was as high as $1 billion; now it's in the $500 million range. We have also moved and repositioned ourselves away from convertibles to just straight debt, so it's a much more effective cost of capital for us as we think about our business. We have done a significant amount of stock repurchasing. We can use the cash for strategic acquisitions and we can also leverage some of the cash for additional growth in our regulated entities, whether they are the Bank or the Brokerage.

So, if you look to the point of returns around repurchasing stock, since we began the program in Q3 of 2001 we have bought back about 70 million shares, a blended cost of about $7.62. And so we generated on that investment somewhere in the neighborhood of a 64% return for our shareholders.

This is a good example of trying to -- as a proof point about the multiple points of revenue from a retail or an institutional customer. You take our core income statement, and you can now see net interest income, which comes consolidated from the relationship with a retail customer, whether it is around any of their credit products -- credit card, margin, mortgages, whatever it may be -- and we're generating about 39% of our revenue from that sort of relationship. Retail commissions were at 23% as of last quarter. Principal transactions are about 17, which is really leveraging that retail and institutional. And then service charging fees are about 13%, and gain on sale of loans as we repositioned the balance sheet is about 8%.

So, I think as Brad has talked about here, what you see is over these last couple of years, absolutely -- one of the big topics as we went into -- certainly coming out of '04 and into '05 was are we in a price war? And what is happening to the marketplace (indiscernible) each of us look at trying to fine-tune our value proposition. And I would argue to you that as you get into businesses which are -- become commoditized and fungible, as all financial services products do over time, there is very little doubt when you have efficiencies in the business and you continue to widen your operating margins that you are going to see over time a decline in the commission. And people have been extremely focused on the investing side about this period of time in the last couple of quarters. Well, truthfully, if you look back from '02 to now, you can see there has been a consistent decline. So, there is very little doubt as businesses have become more efficient and effective, they're passing that through to their customers in the form of a better value proposition.

The point of differentiation I would make is that first of all, you can see from 2002 to '04, that period that we have mapped, you have seen an 11% average annual decline in commission. At the same time you've seen a 9% increase in revenue and a 34% increase in segment income. So what it is really telling you is you're also growing revenue. And while you're growing revenue you're growing it much more cost-effectively. You have been able to lower your costs in a way in which you have -- all of us have widened our operating margins and profitability. And so, that's certainly important to me as I look at the business. The difference is I don't want our model to be entirely dependent on a monoline, just on commissions or just on trading. I want to be able to accomplish exactly this with multiple touch points of revenue from that retail customer.

So, you can see again as I talked about, we're continuing to grow our op margins from 20, 23, 30%; we're now as of last quarter Q1 at 32%, moving again as I said to the stated goal of about 40. So what you can see here is one of the things that we're trying to do is -- okay, what are the proof points?

I think we've stepped back certainly as a management team in these last couple of years and recognized that one of the challenges that we had to overcome from a few years ago was around governance and governance-related issues. So we decided to be as transparent as possible. When you look at when we release our numbers; when we put out our press releases, whether it is monthly or quarterly, there are pages and pages of information about each of the businesses.

But as we've stepped back and said what are the true proof points now for us around our business model? What are we going to hold ourselves accountable to at a high level to prove that the business model that we're building is actually working? You can see this is it. It's really are we growing assets per customer? Are we growing revenue per customer as a result of that asset engagement? What is the segment profit? And most importantly, how are we thinking about if there are? The model is about multiple touch points of revenue from the retail customer and that comes from a product. What are the products per customer? And that's ultimately what we're holding ourselves accountable. And as you can see looking from '03 to '04, you would hopefully see the same sort of growth rates from '04 to '05. Around each of these things we're moving in a direction that I feel quite good about as we really continue to engage with that retail customer.

One of the most important things we need to talk about while we are addressing the issue of the retail relationship and making money by being connected to that customer on the retail side -- you have at the same moment in time this issue of behind door number one you are managing a bank's balance sheet. And you're managing what is now a 26 or $27 billion bank's balance sheet. And fundamentally we have not changed anything that we do in terms of the operation of that bank from when I bought it in '89. And the premise has always been the value creation in that franchise is not going to be on the asset side of the balance sheet, it's going to be on the liability side. It's connecting with that retail customer and building a relationship by providing them value.

So, we have prominently owned mortgage-related product, single-family, first lien position. You can see here the average FICO score is 736. What we have adhered to is by focusing on the super prime borrower and having very tight loan to value, so I think our loan to value blended and our mortgage product is around 72%, about 67% or 68% in first lien position, and it's about 77 or 78% in (indiscernible). So, the goal was to be in a place where we never really had to worry about credit. We didn't play in the credit space. We knew that correspondingly we would have a lower yield on those assets, but that was okay because even if we had a lower yield on the assets and a higher cost of liabilities in a brick and mortar delivery bank, ultimately we could control costs and we could build a deeper engagement with the retail customer. It is exactly why ultimately in 2000 I decided to sell the Bank to E*TRADE and try to build an integrated financial services company, because it would create, I believe, more power with that retail customer and more leverage. But what you can see -- and if you tracked even beyond '02 -- we have had consistently lower charge-offs than the industry? And we should, based on the corresponding yields that we're getting on those assets because of where we are playing in the super prime borrower and with a tighter loan to value.

One of the other questions we have been asked about frequently is what happens in a, a rising rate environment, and b, in an environment where not only are rates rising but the shape of the yield curve is flattening. Because you are managing a balance sheet. You're managing it both, as I said before, $26 billion or so on the bank and integrated about $100 billion for the Company. And so what you can see is we have been operating for some time in an environment where the curve has been -- where the interest rates have been going up and the curve has been flattening. And while that has happened we have been able to significantly widen our spread. And the most significant reason for that is, again, not on the asset side. 99.9% of the reason why we have been successful at widening our spread during this period has come from the engagement with the customers around cash. We have been able to sweep $6 billion of cash over. We've also been able to in that period -- able to organically grow another 1.5 billion or 1.7 billion of cash, by taking prospective customers and current customers and giving them an offer around cash management with functionality like quick transfer, with better rates -- whatever it may be as a result of the engagement -- and deepen and growth, therefore, the amount of cash that comes in organically.

So, as we step back -- (indiscernible) some context for Q1. It was the strongest revenue we have had in the operating history of the Company ever in the 20 years. We did about $420 million in Q1 in revenue; record segment income of about 135 million which is coming from our retail and institutional segments. The consolidated op margin of 32%; again, we're moving in the right direction. We launched E*TRADE Complete which for us is the embodiment of everything that we have been trying to build in a single product. It effectively says to customers -- number one, you can choose any product. We don't have to be all things to all people. As we offer you either a trading solution or a cash management solution or a lending solution, we will make sure that product as you look at it is compelling in the marketplace. There's good value around it. And then independently if you want to deepen the engagement. So, if you want to have multiple products, here is the exponential value that we will provide to you through Complete. And we let the customer choose. So, rather than mandate all things to all people, you're making sure that as you step back -- yes, that product makes sense economically in terms of what I am offering around price, functionality and service as it stands competitively with any other product in the industry, whether it is a lending product or a cash product or a trading or investing product. And then you can deepen that relationship through Complete by saying to the customer as you become more engaged here is the extra value that we are going to give back to you. We launched a new advertising campaign to push Complete. And in the end it's made a huge difference as we have gone through Q1 and now we're into Q2.

GAAP earnings. I think most people are aware we guided back in December to 93 to $1.08, low to high-end. We affirmed that guidance in our Q1 earnings conference call. And then most recently when we did our monthly metrics, we again affirmed that we were comfortable with that same range for the year. So, you can see it translates to revenue of somewhere in the neighborhood of 1.6 billion to 1.8 billion, anywhere from a 5 to a 19% growth rate over the previous year. Operating expenses will be flat to up 10%. Segment income from 530 to 630, up again somewhere between 17 and 39%. And our margin growing on average from 33% to 35% blended for the year. Again, a nice growth rate of anywhere from 300 to 500 basis points.

And with that, we are concluded. Thanks very much.

QUESTIONS AND ANSWERS

Brad Hintz - *Sanford Bernstein - Analyst*

If you could fill out the questions and we will send someone to pick them up at the end of the aisle. So move your questions down to the end of the aisle. In the meantime, I have a couple. Let's talk about the power of your distribution channel. You provide services to mutual fund companies in distributing third-party mutual funds. What sort of trends have you seen in terms of pricing? How important is that in terms of a business for E*TRADE?

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

Our view is, again, we want to be deep at what we think we're good at. So, we built our business along the lines initially of trading. And so we, I think, have a vertical integration. We manufacture that product. We distribute it to customers and we make money on it. Same would be true on the lending side and on the cash management side because of the Bank's balance sheet. When you get onto the traditional asset products, we have viewed that as a scale business that we are -- actually is your point, we're distributing rather than manufacturing. So for us it's really about the economics of the marketplace. And I think you have seen in mutual funds at-large, particularly with the regulatory scrutiny that they have been under, there is a lot more focus on how much of that return is going back to the individual investor and how is the rest of the return being split up between the manufacturer and the distributor. They can be one or they can be two different parties.

So one of the things that we did five quarters ago was we launched the 12-b1 rebate. And we said if you think about our core platform and we've really moved in this direction of it being one global back office, we can be in a place where we can operate on a much thinner margin as a distributor of mutual funds and ETS. So we decided that the most interesting and compelling thing to do was when many of our competitors were so reliant on the fees from 12-b1, and for us it was just generating additional revenue off of that same platform, we would literally tell customers that whatever we got we'd give back 50%, and therefore, ultimately enhance their return.

So what you have seen is with regulatory scrutiny there is definitely pricing pressure around mutual funds, in terms of what they're charging in fees and expenses. And I think we started that in some respects by launching this product around 12-b1. It is great for us. It's another point of differentiation. It lets us say as we step back, as I was trying to describe before, each of our products stand alone -- compelling. Do they make sense in the marketplace? When you look at why would you want to house your mutual fund at one location when you can put it at E*TRADE and that same exact asset can generate a better return for you because we're giving back half of the 12-b1 fees. And since we launched it, we have been able to significantly deepen the relationship. We have grown our mutual funds business and you see it in the form of growth in assets per customer.

Brad Hintz - *Sanford Bernstein - Analyst*

Do the clients also get any fee sharing arrangements, a split on that?

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

No, because effectively -- the answer is really yes, because if you think about the 12-b1, that is a fee-sharing arrangement. We are getting paid by the mutual fund company for distributing it. And what we're saying is whatever we get paid, we're going to give half back in the form of cash to that customer, to our retail customer. So we are ultimately taking an economic value of fee sharing between the manufacturer and the distributor and we're putting half back in the customer's pocket.

Brad Hintz - *Sanford Bernstein - Analyst*

One more, which is, how should we be -- actually for those who don't know, we're in the process of launching on E*TRADE. And were it not for the fact that they were involved in takeovers, this would be done by this point but they keep changing the models on us. How should you value a company that is part bank, valued at a price (indiscernible) and part (indiscernible) valued on a (inaudible)

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

I agree completely. Ultimately, I think it's this question of -- I think as you know, Brad, we would go for earnings calls. I would spend time in the marketplace. And people would say to me, wow, your bank did so well. And you know I would be -- frankly, it's almost amazing to me that I could respond this way since I was the one who founded the Bank in '89, but the Bank just doesn't matter. The Bank is a vehicle. It is a platform that allows you to leverage the retail relationship. We have a unique model in that as we deepen that relationship with the customer and they bring more cash over to us, we can make more money on that cash than the average business model. Why? Because we're choosing to run it on a Bank's platform and other companies aren't.

So the Bank for us isn't the value creation; the value creation is engaging with that retail customer, and that ultimately having an institutional business and being able to prove to ourselves that we can leverage retail flow in a way in which we can make the institutional business more profitable or vice versa. Ultimately, over time I suspect what we will prove is that the vast majority of our revenues and profits are coming from these multiple touch points off of the retail customer from revenue, and that we will get rewarded for it. And again, it's just proof. I mean, I remember at the time when we were at 12, 13, 14, 15,000 in average assets per account, and people said you're nothing more than a trading shop. All of your revenue comes from trading solutions. And now look at us. 20%, and we have figured out how to monetize the relationship. We are at a point where these customer relationships are close to 40,000 in assets and growing. And so in time as we prove out our model, I believe we will get rewarded for it. And I'm pretty patient.

Brad Hintz - *Sanford Bernstein - Analyst*

From the audience we have a number of questions, needless to say, about the consolidation of the industry. And they range from the ones that it's almost certain you can't answer -- would you go hostile with TD Waterhouse and Ameritrade -- to ones that you probably can answer relatively easily, which is -- thoughts generally about the consolidation of the industry. What role will E*TRADE play? And what do you think about a combination of Ameritrade and E*TRADE as a competitor? Would that be a formidable competitor to you and Schwab?

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

For a variety of reasons I think all of us in this space have been talking about the benefits of consolidation. There's very little doubt as you think about putting any two or any three or whatever it is of these companies together. What happens is you undoubtedly have incredible synergies. So, what have we made public? We've made public that we sent a bid to Ameritrade. We made public that we thought that the synergies of putting those two businesses together were in the neighborhood of $650 million. We happen to believe that the synergies with us and any other combination are probably higher, simply because, again, as I said to you, we've got these other touch points in place. So, as you think about putting two businesses together and the other business has got cash and it's not being fully utilized, you can generate a secure return on our platform because we do have the Bank's balance sheet behind door number one.

So in many respects it's pretty remarkable when you think about 650 million in synergies which we made public; it's almost like -- forget anybody else -- it's almost like you're during a three-party deal. One is E*TRADE, one is Ameritrade and the third are the synergies, in that particular example with the (inaudible). I suspect as you look at the industry at large you're going to see that no matter who you look at.

And it was amazing to me that we had not seen consolidation. I very much believe it's the right thing to do for the industry. I think this is a long-term play. I suspect that if we end up partnering with Ameritrade, there will be other consolidation. If we partner with somebody else, there will be other -- this is -- in some respects what was interesting to me is when we sent our bid, I very much believed it was time to shake up the industry. And no matter what happens, the goal here in my mind was to begin the process of consolidation because it's the right thing to do for retail customers, it's the right thing to do for business models, and it's the right thing to do for shareholders.

And I'm not foolish enough to believe that if we literally end up acquiring Ameritrade and we merge together that other people are going to stand still. People are going to figure out what they have to do. It's a question are we a formidable competitor? Sure we are. So, I suspect as a result of that people are going to have to figure out what they have to do in the marketplace to compete with us individually and collectively. And I just think this is -- everybody thinks it's the last inning; I think it's the first inning. I would suspect the first round will be consolidation within our space and the second round will be consolidation with people in our space outside, other financial service players.?

Brad Hintz - *Sanford Bernstein - Analyst*

There seems to be some question about the net interest calculation. One of the questions (indiscernible) there's a group of them, but we could sum it up. Could you please explain again how your net interest spread has grown in an increasing Fed funds rate environment and a flattening of the yield curve? Like -- historically, brokers' margin loan spreads increased in a rising interest rate environment of the bank. (multiple speakers)

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

You're absolutely right. Let me then divide it for you. As we look at net interest income now, it comes from two sources. If you want to think about it behind door number one is the bank's balance sheet and behind door number two is the brokerage balance sheet. We now are in a place where we are literally moving our E*TRADE Clearing Corporation, which is where the margin relationships are housed, under the Bank as an operating subsidiary. So it will consolidate. But for purposes currently of reporting as we report our numbers on our income statement, when you think of net interest income that is the money that E*TRADE Financial makes as a result of its relationship with a retail customer around margins, so they have borrowed -- and to your point, Brad; as interest rates go up, typically you do see a widening.

Interestingly enough for us, we have seen a widening, but a lot less. Because one of the things that I felt when I looked at our margin rates is that we weren't as stand-alone from a value proposition perspective. We weren't as competitive. So if our business model is to say we are offering great value to customers around price, functionality and service, then -- and as I was saying to you before -- as you look at each of these individual products, you have to test them internally and say do the pass the smell test? When you look at the marketplace do you think each of them stand-alone are compelling? And then, can you create more value by integrating them? As interest rates rose, we in fact didn't take our rates up so quickly on the margin product, allowing us to become much more competitive in the marketplace.

When you look at what we're now charging around margin, I believe we are where we need to be. We're very competitive and I think we have benefited from it. Because you have seen a lot less volatility in our margin balances versus a lot of other companies in the market. So, while there has been a lot more volatility around trading behavior, there's been more consistency around margin. That is one touch point that's generated net interest income.

On the Bank's balance sheet -- and you're right. So, as you think of engaging with a retail customer, the optimal model is you simply have that retail customer and you're selling them cash products in the form of a SWEEP account, a CD, a money market account -- whatever it may be. So that goes onto your bank's balance sheet as a liability and represents cost of funds. And then you're selling them a credit relationship outside of margin, whether it is a mortgage product or a HELOC, or whatever it may be. And that is also going on the bank's balance sheet as an asset.

Our yields on our assets are really driven by the marketplace, given that we don't want to take credit risk. And as we look at the business model they're going to be -- if you want to play in the super prime space with a borrower and be very tight on your loan to value, you pretty much know the market-driven yields. So as you look at the last six quarters, even in a rising rate environment and flattening yield curve, we have significantly dropped our cost to fund. And the reason that we have done that plain and simple is because as we have deepened the engagement with the retail customer, as we have been able to bring cash over, although that cash is getting paid a rate that is very competitive in the marketplace, it is significantly lower than what our traditional cost to funds was. So, when you looked at a bank's balance sheet and you look at our cost of funds, it was traditionally driven by deposits and borrowings. And the borrowings may have been wholesale. They had a cost associated with them. They were short duration. You had to extend the duration and pay for hedging. That is one issue.

On the deposit side, as I said, traditionally from the early days certainly of the Bank -- and it's the reason I sold it to the brokerage -- if you were just trying to grow a cash deposit relationship and a monoline offering, you had to pay a much higher rate. Because who were you competing with? You weren't competing broadly in the financial services sector, you were competing with people who paid very high rates on banks -- ING, or Cap One or any of those banks. Whereas we've created this nexus between a retail investing customer and cash, we have been able to pay a rate that is very competitive compared to where they typically put their money, but significantly lower than what our traditional cost to funds was.

So during this period of a rising rate environment and a flattening yield curve, we have significantly brought down our cost to funds on the bank side, therefore widening our spread. And then people say -- well, how much is left? One of the things that we talk about pretty consistently is we've still got in the neighborhood of $5 billion of cash in the system that has yet to be sweep (ph). There's maybe a billion or so that would be difficult because of the tax exempt nature of it, but there is more to sweep. But to me, that is not the game. The game isn't taking what you have and sweeping it; it's looking at are we generating more cash in the system?

So last quarter when you looked in the system, we actually grew 3, 400 million more of cash. And as we have continued to offer better value products around cash management, a big part of what we did with E*TRADE Complete -- in these last six quarters not only have we swept, as I said earlier; we have grown organically over 1.5 billion of cash. So, we are becoming a generator of dollars that can be swept onto the Bank's balance sheet through a retail customer relationship with both what is currently there and sweeping it over, and by focusing and marketing and advertising and growing those dollars organically. And that allows us to continue to lower the cost to funds.

Brad Hintz - *Sanford Bernstein - Analyst*

We have time for one more. And there is clearly a trader in the audience, because we have a question that says the institutional equity divisions of the major brokerage firms don't make money on customer execution. How do you think you can establish an institutional business?

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

We actually are not establishing one; we bought one many years ago. And so, when I think about the equity side -- again, I will repeat what I said earlier. The equity side of our institutional business -- there are really two components. One is simply a market (indiscernible) operation. And I can assure you it is profitable. We talk about it publicly. It used to run. It's gotten tougher, but we use to run in excess of a 40% operating margin in that business. We're now operating it in excess of a 32% operating margin. So, because of the variable comp nature, the variable comp structure, you're still in a place where it is very profitable. And because we are choosing which stocks to make a market in, you can differentiate yourself from somebody who has a business model like Knight, where they freely admit they're making market in stocks across the board; some are profitable, some aren't. We tend to only make markets in those stocks which -- where we have deep concentration because of our retail customer. So it allows us to create best execution for that customer by internalizing.

So there is very little doubt that we have created more value. In fact, one of the things that we talked about in the Ameritrade deal, and it would be true with anybody, is if you consolidate one of the points of value it's because -- just like we have behind door number one -- the Bank's balance sheet, and we can make more money than the average competitor around cash. The same thing is true around trying to leverage that relationship with a customer around trading volume with our market-making operation.

And our sales and execution business institutionally has always been profitable. We bought it in 2000, just about the same time that we bought the Bank. It is a business which has traditionally been sort of soft dollar execution. And the returns on it are fine, but the way in which you juice the returns is by being more engaged with retail. And the other thing that is interesting is to the point people are absolutely right -- we have had a view now for over probably eight quarters that when you think about that business, the growth is not in the traditional execution and settlement, but is in what we call our direct market access product. So we took the technology that we had developed to allow direct trading for the retail customer, and we leveraged that same technology and created it for an institutional customer who wasn't so large that they already had access. So mid to growing size hedge funds are sort of the sweet spot for us in that space. We are out selling them the technology -- we call it (indiscernible) trader -- it's been the fastest-growing product in that business. And we do it -- it's a way in which you're giving the institutions access to direct market access and at a very low cost of execution. So it plays off of our strategy and off of our strength about taking the technology, leveraging it, and trying to generate more revenue from it.

At the same time, because the business was global when we bought it and we have kept it global on the institutional side, we have -- we are in each market. And as we try to get the international business on the retail side to go from significant losses to profit, we did it by pairing all the way back, controlling costs, stepping back, looking at where we were already profitable in countries on the institutional side, and trying to build off of that relationship as we moved into retail. So by operating that international platform institutionally, it helps us on the retail side. And you can see the results, frankly, in our trading volumes internationally.

Brad Hintz - *Sanford Bernstein - Analyst*

Mitch, thank you very much.

Mitch Caplan - *E*TRADE Financial Corp. - CEO*

My pleasure.