E TRADE FINANCIAL CORP
Form 10-Q
November 05, 2004
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2004

Commission file number 1-11921

E*TRADE Financial Corporation

(Exact name of registrant as specified in its charter)

Delaware	**94-2844166**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

135 East 57th Street, New York, New York 10022

(Address of principal executive offices and zip code)

(646) 521-4300

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No ¨

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

As of October 29, 2004, there were 371,908,473 shares of common stock and 1,314,801 shares exchangeable into common stock outstanding. The Exchangeable Shares, which were issued by EGI Canada Corporation in connection with the acquisition of VERSUS Technologies, Inc. (renamed E*TRADE Technologies Corporation effective January 2, 2001), are exchangeable at any time into common stock on a one-for-one basis and entitle holders to dividend, voting, and other rights equivalent to holders of the registrant s common stock.

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E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

FORM 10-Q QUARTERLY REPORT

For the Quarter Ended September 30, 2004

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Unless otherwise indicated, references to the Company, We, Our and E*TRADE FINANCIAL mean E*TRADE Financial Corporation and/or its subsidiaries.

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PART I. FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

(unaudited)

	September 30, 2004	December 31, 2003
ASSETS		
Cash and equivalents	$ 731,031	$ 921,364
Cash and investments required to be segregated under Federal or other regulations (includes repurchase agreements of none at September 30, 2004 and $875,800 at December 31, 2003)	716,643	1,644,605
Brokerage receivables, net	3,684,913	2,297,778
Trading securities	651,151	832,889
Available-for-sale mortgage-backed and investment securities (includes securities pledged to creditors with the right to sell or repledge of $9,261,319 at September 30, 2004 and $5,706,325 at December 31, 2003)	12,051,677	9,826,940
Other investments	41,431	49,272
Loans receivable (net of allowance for loan losses of $42,894 at September 30, 2004 and $37,847 at December 31, 2003)	10,307,413	8,130,906
Loans held-for-sale, net	597,875	1,000,487
Property and equipment, net	287,111	287,097
Derivative assets	133,873	59,990
Accrued interest receivable	108,685	92,565
Investment in Federal Home Loan Bank Stock	100,460	79,236
Goodwill	408,187	392,845
Other intangibles, net	125,130	126,032
Other assets	391,144	307,210
Total assets	$ 30,336,724	$ 26,049,216
LIABILITIES AND SHAREHOLDERS EQUITY		
Brokerage payables	$ 4,132,583	$ 3,696,225
Deposits	12,027,025	12,514,486
Securities sold under agreements to repurchase	9,044,660	5,283,609
Other borrowings by Bank subsidiary	1,617,072	1,203,554
Derivative liabilities	70,411	79,303
Senior notes	400,000	
Convertible subordinated notes	185,165	695,330
Accounts payable, accrued and other liabilities	708,965	658,415
Total liabilities	28,185,881	24,130,922

Commitments and contingencies		
Shareholders equity:		
Preferred stock, shares authorized: 1,000,000; issued and outstanding: none at September 30, 2004 and December 31, 2003		
Shares exchangeable into common stock, $0.01 par value, shares authorized: 10,644,223; issued and outstanding: 1,326,125 at September 30, 2004 and 1,386,125 at December 31, 2003	13	14
Common stock, $0.01 par value, shares authorized: 600,000,000; issued and outstanding: 372,295,993 at September 30, 2004 and 366,636,406 at December 31, 2003	3,723	3,666
Additional paid-in capital	2,270,445	2,247,930
Deferred stock compensation	(16,889)	(12,874)
Retained earnings (deficit)	60,189	(230,465)
Accumulated other comprehensive loss	(166,638)	(89,977)
Total shareholders equity	2,150,843	1,918,294
Total liabilities and shareholders equity	$ 30,336,724	$ 26,049,216

See accompanying notes to unaudited condensed consolidated financial statements.

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E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Brokerage revenues:				
Commissions	$ 64,005	$ 92,885	$ 255,391	$ 239,553
Principal transactions	48,212	64,174	185,088	165,024
Other brokerage-related revenues	35,600	46,285	120,555	133,450
Brokerage interest income	42,871	36,883	127,831	106,071
Brokerage interest expense	(4,795)	(2,442)	(12,049)	(6,832)
Net brokerage revenues	185,893	237,785	676,816	637,266
Banking revenues:				
Banking interest income	250,141	176,254	694,753	545,531
Banking interest expense	(124,057)	(117,481)	(357,567)	(356,768)
Provision for loan losses	(9,145)	(7,988)	(25,701)	(26,149)
Gain on sales of originated loans	12,917	53,308	61,492	171,728
Gain on sales of loans held-for-sale and securities, net	13,108	32,819	42,061	68,974
Other banking-related revenues	8,280	11,246	26,611	26,947
Net banking revenues	151,244	148,158	441,649	430,263
Total net revenues	337,137	385,943	1,118,465	1,067,529
Expenses excluding interest:				
Compensation and benefits	87,264	105,203	286,622	294,910
Occupancy and equipment	19,176	20,527	58,290	65,300
Communications	18,465	19,848	56,000	60,647
Professional services	17,365	16,359	47,401	44,165
Commissions, clearance and floor brokerage	30,894	41,429	116,747	110,125
Advertising and market development	10,232	13,966	49,059	49,366
Servicing and other banking expenses	9,129	9,335	26,579	30,603
Fair value adjustments of financial derivatives	(696)	998	(2,817)	15,736
Depreciation and amortization	20,757	20,129	61,826	68,855
Amortization of other intangibles	6,271	6,988	19,967	20,359
Facility restructuring and other exit charges	(231)	46,998	(1,142)	125,336
Acquisition-related expenses	62	534	186	2,856
Other	18,682	29,056	65,121	81,390
Total expenses excluding interest	237,370	331,370	783,839	969,648
Income before other income (loss), income taxes and discontinued operations	99,767	54,573	334,626	97,881
Other income (loss):				
Corporate interest income	1,698	1,478	4,755	4,981
Corporate interest expense	(11,873)	(11,395)	(35,751)	(34,273)

Gain on sale and impairment of investments	47,229	40,921	107,506	62,641
Loss on early extinguishment of debt	(18,615)		(22,972)	
Equity in income of investments and venture funds	142	2,176	3,206	5,799
Total other income	18,581	33,180	56,744	39,148
Income before income taxes and discontinued operations	118,348	87,753	391,370	137,029
Income tax expense	38,464	25,427	129,467	46,282
Minority interest in subsidiaries	47	43	876	(5,089)
Income from continuing operations	79,837	62,283	261,027	95,836
Discontinued operations, net of tax:				
Income (loss) from discontinued operations, net	(727)	(880)	(1,781)	(264)
Gain on disposal of discontinued operations, net	164		31,408	
Net income (loss) from discontinued operations	(563)	(880)	29,627	(264)
Net income	$ 79,274	$ 61,403	$ 290,654	$ 95,572
Basic income per share from continuing operations	$ 0.21	$ 0.17	$ 0.71	$ 0.27
Basic income (loss) per share from discontinued operations	(0.00)	(0.00)	0.08	(0.00)
Basic net income per share	$ 0.21	$ 0.17	$ 0.79	$ 0.27
Diluted income per share from continuing operations	$ 0.21	$ 0.17	$ 0.68	$ 0.26
Diluted income (loss) per share from discontinued operations	(0.00)	(0.00)	0.07	(0.00)
Diluted net income per share	$ 0.21	$ 0.17	$ 0.75	$ 0.26
Shares used in computation of per share data:				
Basic	369,103	359,432	366,244	356,762
Diluted	380,557	371,173	411,073	364,303

See accompanying notes to unaudited condensed consolidated financial statements.

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E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net income	$ 79,274	$ 61,403	$ 290,654	$ 95,572
Other comprehensive income (loss):				
Available-for-sale securities:				
Unrealized gains (losses)	173,036	(34,607)	46,254	141,208
Less: impact of realized gains (transferred out of AOCI) included in net income	(64,519)	(68,840)	(156,853)	(104,675)
Tax effect	(41,368)	36,075	52,499	(13,100)
Net change from available-for-sale securities	67,149	(67,372)	(58,100)	23,433
Cash flow hedging instruments:				
Unrealized losses	(186,772)	(1,524)	(77,870)	(53,803)
Amortization of losses into interest expense related to de-designated cash flow hedges deferred in AOCI	22,811	29,900	70,945	94,629
Tax effect	63,518	(11,659)	2,519	(10,520)
Net change from cash flow hedging instruments	(100,443)	16,717	(4,406)	30,306
Foreign currency translation gains (losses)	(5,023)	11,397	(14,155)	13,307
Other comprehensive income (loss)	(38,317)	(39,258)	(76,661)	67,046
Comprehensive income	$ 40,957	$ 22,145	$ 213,993	$ 162,618

See accompanying notes to unaudited condensed consolidated financial statements.

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E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in thousands)

(unaudited)

	Shares Exchangeable into Common Stock		Common Stock		Additional Paid-in	Deferred Stock	Retained Earnings	Accumulated Other Comprehensive	Total Shareholders
	Shares	Amount	Shares	Amount	Capital	Compensation	(Deficit)	Loss	Equity
Balance, December 31, 2003	1,386	$ 14	366,636	$ 3,666	$ 2,247,930	$ (12,874)	$ (230,465)	$ (89,977)	$ 1,918,294
Net income							290,654		290,654
Other comprehensive loss								(76,661)	(76,661)
Exercise of stock options and purchase plans, including tax benefit			7,067	71	50,203				50,274
Repurchases of common stock			(9,626)	(96)	(119,714)				(119,810)
Cancellation of restricted stock			(138)	(1)	(1,181)	859			(323)
Issuance of restricted stock			698	7	8,201	(8,108)			100
Shares issued upon debt conversion			7,438	74	79,889				79,963
Amortization of deferred stock compensation						3,234			3,234
Other	(60)	(1)	221	2	5,117				5,118
Balance, September 30, 2004	1,326	$ 13	372,296	$ 3,723	$ 2,270,445	$ (16,889)	$ 60,189	$ (166,638)	$ 2,150,843

	Shares Exchangeable into Common Stock		Common Stock		Additional Paid-in	Deferred Stock	Retained Earnings	Accumulated Other Comprehensive	Total Shareholders
	Shares	Amount	Shares	Amount	Capital	Compensation	(Deficit)	Loss	Equity
Balance, December 31, 2002	1,627	$ 16	358,044	$ 3,580	$ 2,190,200	$ (23,058)	$ (433,492)	$ (231,457)	$ 1,505,789
Net income							95,572		95,572
Other comprehensive income								67,046	67,046
Exercise of stock options and purchase plans, including tax benefit			6,505	66	34,657				34,723
Cancellation of restricted stock			(3,447)	(34)	(21,271)	21,305			
Issuance of restricted stock			1,633	16	12,436	(12,352)			100
Amortization of deferred stock compensation						1,510			1,510
Other	(41)		41						

Balance, September 30, 2003	1,586	$ 16	362,776	$ 3,628	$ 2,216,022	$ (12,595)	$ (337,920)	$ (164,411)	$ 1,704,740

See accompanying notes to unaudited condensed consolidated financial statements.

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E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 290,654	$ 95,572
Non-cash items included in net income:		
Provision for loan losses	25,701	26,149
Depreciation, amortization and premium amortization	297,134	328,223
Recognized loss on impairment of investments	17,914	8,209
Equity in income of subsidiaries and investments	(8,611)	(10,227)
Non-cash restructuring costs and other exit charges	(1,884)	69,057
Amortization of deferred stock compensation	3,234	1,510
Income taxes	20,836	72,005
Gain on disposition of assets	(57,451)	(47)
Gain on sales of investments and loans	(228,892)	(311,792)
Gain on sale of German subsidiary		(4,475)
Unrealized losses on venture funds	5,405	4,383
Other	2,893	14,865
Net effect of changes in brokerage-related assets and liabilities:		
Decrease (increase) in cash and investments required to be segregated under Federal or other regulations	928,560	(872,583)
Increase in brokerage receivables	(1,409,996)	(961,340)
Increase in brokerage payables	431,089	1,772,694
Net effect of changes in banking-related assets and liabilities:		
Proceeds from sales, repayments and maturities of loans held-for-sale	5,283,401	11,929,496
Purchases of loans held-for-sale	(4,819,757)	(10,997,562)
Proceeds from sales, repayments and maturities of trading securities	7,499,672	9,708,699
Purchases of trading securities	(7,327,018)	(10,106,596)
Other changes, net:		
Other assets	(92,262)	43,752
Accrued interest receivable and payable, net	(15,669)	6,660
Accounts payable, accrued and other liabilities	35,999	69,883
Restructuring liabilities	(12,598)	7,061
Net cash provided by operating activities from continuing operations	$ 868,354	$ 893,596
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of mortgage-backed securities, available-for-sale securities and other investments	$ (16,406,991)	$ (15,414,377)
Proceeds from sales, maturities of and principal payments on mortgage-backed securities, available-for-sale securities and other investments	14,182,109	14,622,143
Net increase in loans receivable	(2,255,364)	(1,019,983)
Cash paid for business acquisition	(2,020)	(3,093)
Purchases of property and equipment, net of property and equipment received in business acquisitions	(64,453)	(32,937)
Proceeds from sales of property and equipment	119	6,417

Investing derivative activity	(32,063)	(57,901)
Proceeds from sale of E*TRADE Access	106,868	
Other	(19,465)	850
Net cash used in investing activities from continuing operations	$ (4,491,260)	$ (1,898,881)

See accompanying notes to unaudited condensed consolidated financial statements.

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E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2004	**2003**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in banking deposits	$ (481,055)	$ 3,132,650
Advances from the Federal Home Loan Bank	4,109,000	1,220,700
Payments on advances from the Federal Home Loan Bank	(3,668,000)	(1,611,000)
Net increase (decrease) in securities sold under agreements to repurchase	3,756,328	(1,359,129)
Net decrease in other borrowed funds	(51,225)	(209,268)
Payments on call of convertible subordinated notes	(428,902)	
Proceeds from issuance of senior notes	394,000	
Proceeds from issuance of trust preferred securities	45,880	38,921
Payments on trust preferred securities	(23,375)	
Proceeds from issuance of common stock from employee stock transactions	37,020	30,285
Proceeds from Company loans and lines of credit	77,900	
Payments on Company loans and lines of credit	(46,700)	(5,090)
Repayment of capital lease obligations	(599)	(5,640)
Repurchases of common stock	(119,810)	
Net (issuances) repayments of loans to related parties and associates	(241)	14,163
Financing derivative activity	(156,319)	(22,810)
Net cash provided by financing activities from continuing operations	$ 3,443,902	$ 1,223,782
CASH FLOWS USED IN DISCONTINUED OPERATIONS	$ (11,329)	$ (1,899)
(DECREASE) INCREASE IN CASH AND EQUIVALENTS	(190,333)	216,598
CASH AND EQUIVALENTS Beginning of period	921,364	773,605
CASH AND EQUIVALENTS End of period	$ 731,031	$ 990,203
SUPPLEMENTAL DISCLOSURES:		
Cash paid for interest	$ 317,538	$ 327,048
Cash paid for income taxes	$ 60,524	$ 38,866
Non-cash investing and financing activities:		
Tax benefit on exercise of stock options	$ 14,378	$ 4,825
Reclassification of loans held-for-sale to loans held-for-investment	$	$ 289,592

Transfer from loans to other real estate owned and repossessed assets	$	32,966	$	29,751
Assets acquired under capital lease obligations	$		$	2,678
Common stock issued upon conversion of convertible subordinated notes by election of debtholders	$	79,963	$	

See accompanying notes to unaudited condensed consolidated financial statements.

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND BASIS OF PRESENTATION

Organization

E*TRADE FINANCIAL Corporation (the Company, Parent or E*TRADE FINANCIAL), is a financial services holding company whose subsidiaries provide brokerage and banking services. These subsidiaries include:

Brokerage:

- E*TRADE Securities LLC (E*TRADE Securities), a registered broker-dealer and provider of brokerage services to both retail and institutional customers;
- E*TRADE Clearing LLC (E*TRADE Clearing), the clearing firm for E*TRADE Securities and others;
- Dempsey & Company, LLC (Dempsey) and GVR Company, LLC (GVR), registered broker-dealers, specialists and market-making firms;
- Engelman Securities, Inc. (Engelman), a registered broker-dealer;
- E*TRADE Professional Trading, LLC, a registered broker-dealer;
- E*TRADE Financial Corporate Services, Inc. (E*TRADE Financial Corporate Services), a provider of stock plan administration and options management tools to corporate customers;
- E*TRADE Professional Securities LLC, a registered broker-dealer; and
- E*TRADE Securities Limited, incorporated in the U.K., E*TRADE Securities Limited, incorporated in Hong Kong, and E*TRADE Canada Securities Corp., providers of brokerage services to both retail and institutional customers.

Banking:

E*TRADE Re, LLC, the holding company of ETB Holdings, Inc. (ETBH) and also a provider of mortgage reinsurance. ETBH s subsidiaries include:

E*TRADE Bank (the Bank), a Federally chartered savings bank that provides deposit accounts insured by the Federal Deposit Insurance Corporation (FDIC) and consumer lending products to retail customers nationwide. The Bank is also the parent company of:

E*TRADE Mortgage Corporation (E*TRADE Mortgage), a direct-to-consumer mortgage loan originator; and

E*TRADE Consumer Finance Corporation (E*TRADE Consumer Finance), a recreational vehicle, marine and other consumer loan originator and servicer.

E*TRADE Global Asset Management, Inc. (ETGAM), a registered broker-dealer and investment advisor that manages asset portfolios for the Brokerage and Banking segments, as well as institutional customers.

Basis of Presentation

These condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and Regulation S-X, Article 10 under the Securities Exchange Act of 1934. They are unaudited and exclude some of the disclosures for annual financial statements. Management believes it has made all necessary adjustments so that the financial

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statements are presented fairly. The results of operations for the nine months ended September 30, 2004 may not be indicative of future results. Certain prior period amounts have been reclassified to conform to the current period presentation. As discussed in Note 3, the operations of E*TRADE Access, Inc. (E*TRADE Access) have been accounted for as discontinued operations in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Accordingly, prior period amounts have been reclassified to reflect E*TRADE Access as a discontinued operation. Unless noted, discussions herein pertain to the Company s continuing operations. Because the Company operates in the financial services industry, it follows accounting guidance used by the brokerage and banking industries.

These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements of E*TRADE Financial Corporation, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

SAB No. 105 Loan Commitments Accounted for as Derivative Instruments

In March 2004, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin (SAB) No. 105*, Loan Commitments Accounted for as Derivative Instruments.* This SAB was issued to help ensure that companies consistently apply pre-existing generally accepted accounting principles associated with loan commitments accounted for as derivative instruments. The Company s previous and current practices are consistent with those described in SAB No. 105. Thus, this SAB has no effect on the Company s consolidated financial statements.

EITF 03-01 The Meaning of Other-Than-Temporary Impairment and its Application to Certain Issues

In March 2004, the Emerging Issues Task Force (EITF) amended and ratified previous consensus reached on EITF 03-01, *The Meaning of Other-Than-Temporary Impairment*. This amendment, which was originally effective for financial periods beginning after June 15, 2004, introduced qualitative and quantitative guidance for determining whether securities are other-than-temporarily impaired. In September 2004, the Financial Accounting Standards Board s (FASB) staff issued a number of positions (FSP) that focused primarily upon the application of EITF 03-01 to debt securities that are impaired solely due to interest rates and/or sector spreads. Subsequently, FASB suspended the effective date of the application of the majority of EITF 03-01 for an unspecified period, pending additional review. In the interim, the Company continues to apply earlier authoritative accounting guidance to the measurement and recognition of other-than-temporary impairments of its debt and equity securities.

NOTE 3 DISCONTINUED OPERATIONS

On June 30, 2004, the Company s Banking segment completed the sale of substantially all of the assets and liabilities of E*TRADE Access to Cardtronics, LP and Cardtronics, Inc., for $106.7 million cash. Although the Company believes that the ATM network is an important distribution channel for its customers, it determined that its continued ownership and direct operation of the ATM network was not essential to providing this customer benefit and that the capital it had invested in this endeavor could be better applied to other operations.

The sale resulted in a $57.5 million pre-tax gain ($31.4 million after taxes). As part of the sales agreement, Cardtronics assumed substantially all of the liabilities of E*TRADE Access, including contingent liabilities that could result from litigation that was pending final resolution as of June 30, 2004. Under the sales agreement, the Company continues to retain the obligation for certain unasserted contingent liabilities that may have existed prior to the sale, primarily employment-related claims. The Company has reflected E*TRADE Access results of operations, financial position and cash flows as discontinued operations in the unaudited condensed consolidated financial statements for all periods reported herein. The results of operations for the three months ended September 30, 2004 also reflect a resolution of remaining open items associated with the sale of E*TRADE Access.

The following table summarizes the results of discontinued operations for the three and nine months ended September 30, 2004 and 2003 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Revenues	$	$ 11,762	$ 20,029	$ 33,433
Loss from discontinued operations before income taxes	$ (1,194)	$ (1,440)	$ (3,121)	$ (435)
Benefit for income taxes	467	560	1,340	171
Loss from discontinued operations	$ (727)	$ (880)	$ (1,781)	$ (264)

The following table summarizes the discontinued assets and liabilities of E*TRADE Access at September 30, 2004 and December 31, 2003 (in thousands):

	September 30, 2004	December 31, 2003
Assets:		
Cash and equivalents	$	$ 75
Other investments		34
Property and equipment, net		14,161
Goodwill		9,651
Other intangibles, net		17,958
Other assets	2,103	5,906
Total assets of discontinued operations (1)	$ 2,103	$ 47,785
Liabilities:		
Accounts payable, accrued and other liabilities	$ 10,913	$ 13,037
Total liabilities of discontinued operations (1)	$ 10,913	$ 13,037

(1) All discontinued assets are reflected on the Consolidated Balance Sheets on the line titled other assets and all discontinued liabilities are reflected on the line titled accounts payable, accrued and other liabilities.

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NOTE 4 BROKERAGE RECEIVABLES, NET AND PAYABLES

Brokerage receivables, net and payables consist of the following (in thousands):

	September 30, 2004	December 31, 2003
Receivable from customers and non-customers (less allowance for doubtful accounts of $1,980 at September 30, 2004 and $1,082 at December 31, 2003)	$ 2,055,349	$ 1,820,161
Receivable from brokers, dealers and clearing organizations:		
Net settlement and deposits with clearing organizations	148,842	128,419
Deposits paid for securities borrowed	1,429,270	315,789
Securities failed to deliver	15,874	2,592
Other	35,578	30,817
Total brokerage receivables, net	$ 3,684,913	$ 2,297,778
Payable to customers and non-customers	$ 2,190,489	$ 3,123,478
Payable to brokers, dealers and clearing organizations:		
Deposits received for securities loaned	1,821,619	521,454
Securities failed to receive	9,852	4,978
Other	110,623	46,315
Total brokerage payables	$ 4,132,583	$ 3,696,225

Receivable from customers and non-customers represents credit extended to customers and non-customers to finance their purchases of securities on margin, as well as commission receivables from customers upon settlement of their trades. Receivable from non-customers include credit extended to principal officers and directors of the Company to finance their purchases of securities on margin the balances of which were approximately $104.9 million, $101.5 million, $106.2 million and $95.4 million, as of September 30, 2004, June 30, 2004, March 31, 2004 and December 31, 2003, respectively. These balances are maintained under the same collateral requirements as those of customers. Receivable from and payable to brokers, dealers and clearing organizations result from the Company s brokerage activities. Credit extended to customers and non-customers with respect to margin accounts was $2,023 million at September 30, 2004 and $1,752 million at December 31, 2003. Securities owned by customers and non-customers were held as collateral for amounts due on margin balances, the value of which is not reflected in the accompanying unaudited condensed consolidated balance sheets. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to enter into securities lending transactions, to collateralize borrowings, or for delivery to counterparties to cover customer short positions. As of September 30, 2004, the fair value of securities that the Company has received as collateral (primarily in connection with securities borrowed and customer margin loans) where the Company is permitted to sell or repledge the securities was $4,104 million. Of this amount, $1,974 million has been pledged or sold as of September 30, 2004 in connection with securities loans, bank borrowings and deposits with clearing organizations. Payable to customers and non-customers represents free credit balances and other customer and non-customer funds pending completion of securities transactions. The Company pays interest on certain customer and non-customer credit balances. Other brokerage payables include securities sold but not yet purchased.

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NOTE 5 AVAILABLE-FOR-SALE MORTGAGE-BACKED AND INVESTMENT SECURITIES

The amortized cost basis and estimated fair values of available-for-sale mortgage-backed and investment securities are shown in the following table (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Values
September 30, 2004:				
Mortgage-backed securities:				
U.S. Government sponsored enterprise obligations:				
Federal National Mortgage Association	$ 4,189,578	$ 985	$ (89,654)	$ 4,100,909
Government National Mortgage Association	2,911,036		(77,937)	2,833,099
Federal Home Loan Mortgage Corporation	28,476	35	(1,192)	27,319
Total U.S. Government sponsored enterprise	7,129,090	1,020	(168,783)	6,961,327
Collateralized mortgage obligations	1,700,265	1,606	(12,938)	1,688,933
Private issuer and other	7,807	17	(336)	7,488
Total mortgage-backed securities	8,837,162	2,643	(182,057)	8,657,748
Investment securities:				
Debt securities:				
Asset-backed securities	2,670,350	29,889	(13,737)	2,686,502
Corporate bonds	98,684	6	(3,395)	95,295
Municipal bonds	116,981	3,364	(686)	119,659
Other debt securities	79,888	3	(5,064)	74,827
Total debt securities	2,965,903	33,262	(22,882)	2,976,283
Publicly traded equity securities	298,699	95,852	(1,128)	393,423
Retained interests from securitizations	24,223			24,223
Total investment securities	3,288,825	129,114	(24,010)	3,393,929
Total available-for-sale securities	$ 12,125,987	$ 131,757	$ (206,067)	$ 12,051,677
December 31, 2003:				
Mortgage-backed securities:				
U.S. Government sponsored enterprise obligations:				
Federal National Mortgage Association	$ 2,860,218	$ 453	$ (70,945)	$ 2,789,726
Government National Mortgage Association	2,339,066		(69,779)	2,269,287
Federal Home Loan Mortgage Corporation	138,229	565	(3,087)	135,707
Total U.S. Government sponsored enterprise	5,337,513	1,018	(143,811)	5,194,720
Collateralized mortgage obligations	1,965,930	4,992	(18,885)	1,952,037
Private issuer and other	10,465	461	(294)	10,632
Total mortgage-backed securities	7,313,908	6,471	(162,990)	7,157,389

Investment securities:				
Debt securities:				
Asset-backed securities	2,000,239	26,031	(15,541)	2,010,729
Corporate bonds	122,583	67	(6,620)	116,030
Municipal bonds	44,906	740		45,646
Other debt securities	89,944	18	(6,590)	83,372
Total debt securities	2,257,672	26,856	(28,751)	2,255,777
Publicly traded equity securities	201,777	182,737	(1,533)	382,981
Retained interests from securitizations	30,793			30,793
Total investment securities	2,490,242	209,593	(30,284)	2,669,551
Total available-for-sale securities	$ 9,804,150	$ 216,064	$ (193,274)	$ 9,826,940

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Other-Than-Temporary Impairment of Investments

The following table shows the fair value and unrealized losses on investments, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position at September 30, 2004 (in thousands):

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities:						
Backed by Federal agencies	$ 4,577,593	$ (102,909)	$ 1,931,889	$ (65,874)	$ 6,509,482	$ (168,783)
Other	1,173,100	(10,012)	194,126	(3,262)	1,367,226	(13,274)
Total U.S. Government sponsored enterprise	5,750,693	(112,921)	2,126,015	(69,136)	7,876,708	(182,057)
Investment securities:						
Asset-backed securities	372,304	(3,240)	45,683	(10,497)	417,987	(13,737)
Corporate bonds			85,028	(3,395)	85,028	(3,395)
Municipal bonds	41,674	(681)	405	(5)	42,079	(686)
Other debt securities			74,827	(5,064)	74,827	(5,064)
Publicly traded equity securities	12,767	(1,128)			12,767	(1,128)
Total investment securities	426,745	(5,049)	205,943	(18,961)	632,688	(24,010)
Total temporarily impaired securities	$ 6,177,438	$ (117,970)	$ 2,331,958	$ (88,097)	$ 8,509,396	$ (206,067)

The Company regularly analyzes certain available-for-sale investments for other-than-temporary impairment when the fair value of the investment is lower than its book value. The Company s methodology for determining impairment involves projecting cash flows relating to each investment and using assumptions as to future prepayment speeds, losses and loss severities over the life of the underlying collateral pool. Assumptions about future performance are derived from the actual performance to date and the Company s view on how the collateral will perform in the future. In projecting future performance, the Company incorporates the views of industry analysts, rating agencies and the management of the issuer, along with its own independent analysis of the issuer of the securities, the servicer, the economy and the relevant sector as a whole. If the Company determines impairment is other-than-temporary, it reduces the recorded book value of the investment by the amount of the impairment and recognizes a realized loss on the investment. The Company does not, however, adjust the recorded book value for declines in fair value that it believes are temporary. The Company has the intent and ability to hold these securities for the foreseeable future and has not made the decision to dispose of these securities as of September 30, 2004. Management continues to monitor and evaluate these securities closely for impairment that is other-than-temporary.

Mortgage- and asset-backed securities that both have an unrealized loss and are rated below AA by at least half of the agencies that rate the securities, as well as interest-only securities that have unrealized losses, are evaluated for impairment in accordance with EITF 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets*. Accordingly, when the present value of a security s anticipated cash flows declines below the last periodic estimate, the Company recognizes an impairment charge in gains on sales of loans held-for-sale and securities, net on the unaudited condensed consolidated statements of operations. At September 30, 2004, the Company evaluated the following securities that had unrealized losses (in thousands):

	Securities Tested for Other-than-Temporary Impairment			
	Asset-Backed	**Mortgage-Backed**	**Interest Only**	**Total**
Fair value	$ 137,359	$ 12,775	$ 115,518	$ 265,652
Book value	150,071	13,030	123,613	286,714
Total unrealized loss	$ (12,712)	$ (255)	$ (8,095)	$ (21,062)

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Based on its evaluation, the Company recorded an other-than-temporary charge of $9.3 million and $13.6 million for the three and nine months ended September 30, 2004, respectively, for its asset- and mortgage-backed securities and interest-only securities. The Company also recognized $4.4 million of other-than-temporary impairments during the nine months ended September 30, 2004, from retained beneficial interests in securitized receivables held by a subsidiary, ETCF Asset Funding Corporation, formerly Deutsche Recreational Asset Funding Corporation (DRAFCO).

Publicly Traded Equity Securities

Publicly traded equity securities include shares of Softbank Investment Corporation (SBI) received in 2003 in exchange for the Company s investment in E*TRADE Japan K.K. The Company sold shares of SBI resulting in a gain of $45.4 million for the three months ended September 30, 2004 and $109.9 million for the nine months ended September 30, 2004. At September 30, 2004, the Company s ownership in SBI was 3.90% and the fair value of its investment in SBI was $104.6 million, including a gross unrealized gain of $88.2 million which is reflected as a component of accumulated other comprehensive loss (AOCI).

NOTE 6 LOANS, NET

Loans, net are summarized as follows (in thousands):

	September 30, 2004		
	Held-for-Investment	**Held-for-Sale**	**Total Loans**
Real estate loans:			
One- to four-family	$ 3,348,657	$ 311,164	$ 3,659,821
Home equity lines of credit and second mortgage	2,724,200	2,277	2,726,477
Multi-family		88	88
Commercial	1,633		1,633
Mixed-use and land	64		64
Total real estate loans	6,074,554	313,529	6,388,083
Consumer and other loans:			
Recreational vehicle	2,461,194	219,596	2,680,790
Automobile	715,174		715,174
Marine	712,562	51,409	763,971
Credit card	191,251		191,251
Lease financing	2,070		2,070
Other	17,008	3,761	20,769
Total consumer and other loans	4,099,259	274,766	4,374,025
Total loans	10,173,813	588,295	10,762,108
Unamortized premiums (discounts), net	176,494	9,580	186,074

Less allowance for loan losses	(42,894)		(42,894)
Total	$ 10,307,413	$ 597,875	$ 10,905,288

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	December 31, 2003		
	Held-for-Investment	Held-for-Sale	Total Loans
Real estate loans:			
One- to four-family	$ 2,289,196	$ 966,334	$ 3,255,530
Home equity lines of credit and second mortgage	1,511,452	315	1,511,767
Multi-family		97	97
Commercial	12,279		12,279
Mixed-use and land	72		72
Total real estate loans	3,812,999	966,746	4,779,745
Consumer and other loans:			
Recreational vehicle	2,263,606	21,845	2,285,451
Automobile	1,162,339		1,162,339
Marine	625,484	2,491	627,975
Credit card	113,434		113,434
Lease financing	2,651		2,651
Other	13,305	262	13,567
Total consumer and other loans	4,180,819	24,598	4,205,417
Total loans	7,993,818	991,344	8,985,162
Unamortized premiums, net	174,935	9,143	184,078
Less allowance for loan losses	(37,847)		(37,847)
Total	$ 8,130,906	$ 1,000,487	$ 9,131,393

Activity in the allowance for loan losses is summarized as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Allowance for loan losses, beginning of the period	$ 40,938	$ 32,672	$ 37,847	$ 27,666
Provision for loan losses	9,145	7,988	25,701	26,149
Purchased reserve	1,548	142	1,548	2,748
Charge-offs	(14,111)	(12,057)	(38,125)	(39,395)
Recoveries	5,374	5,263	15,923	16,840
Allowance for loan losses, end of period	$ 42,894	$ 34,008	$ 42,894	$ 34,008

NOTE 7 GOODWILL AND DEFERRED TAX ASSETS

During the three months ended September 30, 2004, the Company finalized certain contingencies related to its acquisition of ETCF Asset Funding Corporation, formerly DRAFCO. When this business was acquired from Deutsche Bank AG in 2003, the Company recorded deferred tax assets based on management s best estimate of the tax basis that would be accepted by the tax authority upon ultimate settlement. In September 2004, management s best estimate of the ultimate tax basis was modified and the Company recorded a $15.8 million adjustment to deferred tax assets to reflect the revised tax basis. In accordance with EITF 93-7 *Uncertainties Related to Income Taxes in a Purchase Business Combination,* the adjustment was applied as an increase to the balance of goodwill attributable to that acquisition.

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NOTE 8 SERVICING RIGHTS

Included in other assets, in the consolidated balance sheets are servicing assets which are recognized when the Company sells a loan and retains the related servicing rights. The servicing right is initially recorded at its allocated cost basis based on the relative fair value of the loan sold and the servicing retained at the date of the sale in accordance with SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The fair value of the servicing retained is estimated based on market quotes for similar servicing assets. Servicing assets are amortized in proportion to and over the period of estimated net servicing income. The Company measures impairment by stratifying the servicing assets based on the characteristics of the underlying loans and by interest rates. Impairment is recognized through a valuation allowance for each stratum. The valuation allowance is adjusted to reflect the excess of the servicing assets cost basis for a given stratum and its fair value. Any fair value in excess of the cost basis of servicing assets for a given stratum is not recognized. The Company estimates the fair value of each stratum based on an industry standard present value of cash flows model. The Company recognizes both amortization of servicing rights and impairment charges in other banking-related revenues on the unaudited condensed consolidated statements of operations.

The following table shows the net amortized cost of the Company s servicing rights for the three and nine months ended September 30, 2004 and 2003 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Servicing assets				
Balance beginning of period	$ 30,643	$ 29,551	$ 32,773	$ 27,235
Additions resulting from acquisition	295	6,757	2,168	15,235
Amortization of servicing rights	(1,754)	(2,191)	(5,757)	(8,353)
Balance end of period	29,184	34,117	29,184	34,117
Valuation allowance for impairment:				
Balance beginning of period	(5,683)	(5,312)	(5,379)	(583)
Valuation adjustment	(469)	124	(773)	(4,605)
Balance end of period	(6,152)	(5,188)	(6,152)	(5,188)
Servicing rights, end of period	$ 23,032	$ 28,929	$ 23,032	$ 28,929

The most important assumptions used in determining the estimated fair value are anticipated loan prepayments and discount rates. The Company uses market-based assumptions and confirms the reasonableness of the Company s valuation model through management s quarterly review, analyses of market quotes and independent broker valuations of the fair value of the servicing rights.

The following summarizes the estimated fair values of the Company s servicing assets and significant assumptions as of September 30, 2004 and December 31, 2004 (dollars in thousands):

	September 30, 2004	December 31, 2003
Mortgage servicing assets:		
Fair value	$ 17,947	$ 21,111
Constant prepayment rate	13%	18%
Discount rate	6.0% - 6.5%	4.0% - 4.5%
Consumer servicing assets:		
Fair value	$ 5,085	$ 6,283
Constant prepayment rate	23% - 29%	26% - 27%
Discount rate	8%	8%

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NOTE 9 DEPOSITS

Deposits are summarized as follows (dollars in thousands):

	Weighted-Average Rate		Balance at		Percent	
	September 30, 2004	December 31, 2003	September 30, 2004	December 31, 2003	September 30, 2004	December 31, 2003
Money market	1.15%	1.36%	$ 3,457,706	$ 4,412,329	28.8%	35.3%
Sweep deposit	0.40%	0.15%	5,608,205	4,258,770	46.6	34.0
Certificates of deposit	3.39%	3.36%	2,252,693	3,234,139	18.7	25.8
Brokered certificates of deposit	2.32%	2.78%	325,931	292,476	2.7	2.4
Passbook savings	1.16%	1.78%	730	809		
Checking:						
Interest-bearing	0.67%	0.80%	381,463	315,351	3.2	2.5
Non-interest-bearing	%	%	297	612		
Total			$ 12,027,025	$ 12,514,486	100.0%	100.0%

NOTE 10 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND OTHER BORROWINGS BY BANK SUBSIDIARY

The Bank s borrowings by category are shown below (in thousands):

	September 30, 2004	December 31, 2003
Securities sold under agreements to repurchase	$ 9,044,660	$ 5,283,609
Other borrowings by Bank subsidiary:		
Federal Home Loan Bank advances	1,361,000	920,000
Subordinated debentures	225,491	201,665
Other	30,581	81,889
Total other borrowings by Bank subsidiary	1,617,072	1,203,554
Total borrowings	$ 10,661,732	$ 6,487,163

ETBH raises capital through the formation of trusts, which sell trust preferred stock in the capital markets. The capital securities are mandatorily redeemable in whole at the due date, which is generally 30 years after issuance. Each trust issues Floating Rate Cumulative Preferred Securities, at par with a liquidation amount of $1,000 per capital security. The proceeds from the sale of issuances were invested in ETBH s Floating Rate Junior Subordinated Debentures. All five subordinated debentures issued by ETBH in 2004 pay interest each quarter at rates that are identical to the quarterly dividend rate paid by the associated Capital Trust. Key information regarding the issuances made during the nine months ended September 30, 2004 is provided in the following table (dollars in thousands):

Floating Rate Junior Subordinated Debenture Issue Date	**Maturity Date**	**Face Value**	**Annual Interest Rate**	**1st Quarterly Payment Due**
Quarter ended March 31, 2004:				
February 2004	2034	$ 10,000	2.85% above 3-month LIBOR	April 2004
February 2004	2034	$ 5,000	2.90% above 3-month LIBOR	April 2004
March 2004	2034	$ 10,000	2.80% above 3-month LIBOR	July 2004
Quarter ended June 30, 2004:				
May 2004	2034	$ 12,000	2.80% above 3-month LIBOR	July 2004
June 2004	2034	$ 10,000	2.70% above 3-month LIBOR	October 2004

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In June 2004, the Company called a $24.2 million Floating Rate Junior Subordinated Debenture, which was originally scheduled to mature in 2028 and paid 9% interest. Telebanc Capital Trust II held this subordinated debt, which was callable at par. Upon settlement on July 8, 2004, the Company recognized a $1.1 million charge recorded as loss on early extinguishment of debt, for the remaining unamortized discount and issuance costs incurred when the debenture was originally issued. No trusts were formed or debentures issued during the three months ended September 30, 2004.

NOTE 11 SENIOR NOTES AND CONVERTIBLE SUBORDINATED NOTES

The Company s long-term debt by type is shown below (in thousands):

	September 30, 2004	December 31, 2003
Senior 8.00% Notes, due 2011	$ 400,000	$
Convertible subordinated notes:		
6.75% Notes, due 2008		325,000
6.00% Notes, due 2007	185,165	370,330
Total convertible subordinated notes	185,165	695,330
Total senior and convertible subordinated notes	$ 585,165	$ 695,330

In June 2004, the Company completed a private offering of an aggregate principal amount of $400 million in senior notes due June 2011. The senior notes bear interest at 8.00%, payable semi-annually, and are non-callable for four years and may then be called by the Company at a premium, which declines over time. Original debt issuance costs of $8.2 million are included in other assets and are being amortized over the term of the senior notes.

In June 2004, the Company called $162.5 million of the 6.75% Notes and in July 2004, called the remaining $162.5 million. Of these notes, total principal of $81.3 million was converted into 7.4 million shares of the Company s common stock, with $1.3 million recorded in additional paid-in capital for its portion of the premium and unamortized debt offering costs. The remaining principal of $243.7 million was redeemed for cash, with a total $12.6 million charge recorded as loss on early extinguishment of debt, for its portion of the premium paid and write-off of unamortized debt offering costs, of which $8.3 million was recorded in the three months ended September 30, 2004.

In July 2004, the Company called $185.2 million of its 6.00% Notes for cash, with a $6.8 million charge recorded as loss on early extinguishment of debt, for its portion of the premium paid and write-off of unamortized debt offering costs in the three months ended September 30, 2004.

NOTE 12 SHAREHOLDERS EQUITY

Stock Repurchases

On April 29, 2004, the Company announced that it had completed its $100 million stock repurchase program, approved on December 9, 2003. Through the program, the Company repurchased a total of approximately 7.9 million shares of its common stock at a weighted-average price of $12.73 for an aggregate amount of $100 million.

Also on April 29, 2004, the Company announced that its Board of Directors authorized a new $200 million repurchase program. As with the previous plan, the Company s Board of Directors determined that the use of cash to reduce outstanding debt and outstanding common stock was likely to create long-term value for its shareholders. The new plan is open-ended and provides the flexibility to buy back common stock, redeem for cash its outstanding convertible subordinated notes, retire debt in the open market or a combination of all three.

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For the nine months ended September 30, 2004, the Company used $86.2 million in cash for a partial redemption of its 6.75% Notes, which included premiums of $2.8 million, paid above the principal. The Company paid an equivalent percentage to all noteholders. For the three and nine months ended September 30, 2004, the Company repurchased a total of approximately 1.8 million shares of its common stock at a weighted-average price of $11.19 for an aggregate amount of $19.8 million. As of September 30, 2004, the Company had approximately $93.9 million available under the authorized plan to purchase additional shares of its common stock or retire additional debt.

Restricted Common Stock and Deferred Stock Compensation

In 2004, the Company issued 0.7 million shares of restricted common stock to its executive officers and other employees, thereby increasing the amount of deferred stock compensation in the accompanying unaudited condensed consolidated balance sheets by $8.1 million, the fair market value of the shares on the date of grant. Of these grants, 0.5 million shares vest annually over a four-year period and 0.2 million shares vest 100% on the five-year anniversary of the date of grant. The Company will recognize compensation expense related to these shares ratably over the applicable vesting periods.

Stock-Based Compensation

The Company applies the intrinsic value recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for its employee stock option plans. If any stock options are granted to employees for which the grant price is below the market price on the date of grant, the Company records an expense for the difference between the market price and the grant price on the date of the grant.

The following table illustrates the effect on the Company s reported net income and net income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income, as reported	$ 79,274	$ 61,403	$ 290,654	$ 95,572
Add back: Stock-based employee compensation expense included in reported net income, net of tax	772	1,057	2,145	1,572
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of tax	(5,683)	(4,440)	(14,559)	(9,681)
Pro forma net income	$ 74,363	$ 58,020	$ 278,240	$ 87,463
Income per share:				
Basic as reported	$ 0.21	$ 0.17	$ 0.79	$ 0.27
Basic pro forma	$ 0.20	$ 0.16	$ 0.76	$ 0.25

Diluted as reported	$ 0.21	$ 0.17	$ 0.75	$ 0.26
Diluted pro forma	$ 0.20	$ 0.16	$ 0.72	$ 0.24

Under SFAS No. 123, the fair value of stock-based awards to employees is calculated using option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company s stock option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values.

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The Company s calculations were made using the Black-Scholes option-pricing model with the following weighted average assumptions applied to grants made in the following periods:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Dividend yield				
Expected volatility	47%	68%	52%	66%
Risk-free interest rate	3%	3%	2%	3%
Expected life of option following vesting (in months)	22	16	22	19

The valuations of the computed weighted average fair values of all option grants under SFAS No. 123 were $4.50 for the three months ended September 30, 2004, $2.53 for the three months ended September 30, 2003, $5.52 for the nine months ended September 30, 2004 and $2.63 for the nine months ended September 30, 2003. During the nine months ended September 30, 2003, the Company granted approximately 6.1 million options to its non-executive employees with a value of $1.47 per share. The expected lives for the three and nine months ended September 30, 2003 are lower than in 2004 principally due to these non-executive employee option grants and related exercises during 2003, which had vesting terms within the year of grant.

NOTE 13 RESTRUCTURING AND OTHER EXIT CHARGES

The following table summarizes the amounts recognized by the Company as facility restructuring and other exit charges for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
2003 Restructuring Plan	$ 83	$ 40,610	$ (355)	$ 110,872
2001 Restructuring Plan	(284)	3,813	(1,124)	14,878
Other exit activity	(30)	2,575	337	(414)
Total facility restructuring and other exit charges	$ (231)	$ 46,998	$ (1,142)	$ 125,336

2003 Restructuring Plan

In April 2003, the Company announced a restructuring plan (2003 Restructuring Plan) exiting and consolidating leased facilities and exiting and disposing of certain unprofitable product offerings and initiatives. The original 2003 facility consolidation charge primarily related to charges to exit the E*TRADE FINANCIAL Center in New York and consolidation of excess facilities located in Menlo Park and Rancho Cordova,

California. The E*TRADE FINANCIAL Center in New York, encompassing approximately 31,000 square feet, was used by customers to access the Company s products and services and serve as an introduction point for new customers to the Company s products and services. The Company exited the Center as it was not cost effective to engage in these activities within a facility of its size, and subsequently, opened an approximately 2,000 square foot Center in New York that was more cost effective. The leased California facilities were used for corporate and administrative functions and were exited as the Company consolidated employees into nearby offices and redeployed certain functions to its offices in Virginia.

The other charges related to the exit of or write-off of unprofitable product lines and the early termination of certain contracts, such as the revenue sharing agreements associated with 43 E*TRADE Zones located in Target stores. These unprofitable product lines consisted of our Stock Basket product offered to customers and our online advisory service, eAdvisor, a joint initiative with Enlight Holdings, LLC. The Company terminated its revenue sharing agreements associated with its Zones in Target stores as it decided to terminate the Zone strategy and focus on other methods of reaching its current and potential customers, as well as for the reason that the Zones were unprofitable.

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In 2004, the Company finalized its exit of the product offering with Enlight Holdings, LLC, and as a result made adjustments to previously estimated costs associated with its exit. The rollforward of the 2003 Restructuring Plan reserve is presented below (in thousands):

	Facility Consolidation	Other	Total
Original 2003 Restructuring Reserve:			
Facility restructuring and other exit activity recorded in 2003	$ 55,010	$ 57,960	$ 112,970
Cash payments	(11,007)	(16,369)	(27,376)
Non-cash charges	(19,254)	(38,370)	(57,624)
Restructuring liabilities at December 31, 2003	24,749	3,221	27,970
2004 activity on original 2003 restructuring reserve:			
Adjustment and additional charges recorded in 2004	203	(558)	(355)
Cash payments	(4,193)	(2,158)	(6,351)
Restructuring liabilities at September 30, 2004	$ 20,759	$ 505	$ 21,264

2001 Facility Restructuring Plan

In August 2001, the Company announced a restructuring plan (2001 Restructuring Plan) aimed at streamlining operations primarily by consolidating facilities in the United States and Europe. The restructuring was designed to consolidate certain facilities, to bring together key decision-makers and to streamline operations. The original 2001 restructuring charge related to facility consolidation, representing the undiscounted value of ongoing lease commitments, offset by anticipated third-party sublease revenues, the write-off of capitalized software, hardware and other fixed assets and other costs. Subsequent to 2001, the Company recognized additional facility consolidation adjustments, as a result of updated estimates of sublease income and sublease start dates, driven by economic circumstances. The rollforward of the 2001 Restructuring Plan reserve is presented below (in thousands):

	Facility Consolidation	Asset Write-Off	Other	Total
Total 2001 facility restructuring and other nonrecurring charges recorded in 2001	$ 128,469	$ 52,532	$ 21,764	$ 202,765
Activity through December 31, 2003:				
Adjustments and additional charges	22,204	2,072	3,499	27,775
Cash payments	(92,881)	(67)	(19,281)	(112,229)
Non-cash charges	(41,263)	(53,877)	(5,810)	(100,950)
Restructuring liabilities at December 31, 2003	16,529	660	172	17,361
2004 activity on original 2001 restructuring reserve:				
Adjustments and additional charges recorded in 2004	(1,124)			(1,124)
Cash payments	(4,783)		(5)	(4,788)
Restructuring liabilities at September 30, 2004	$ 10,622	$ 660	$ 167	$ 11,449

Other Exit Activity

Other exit activity for the three and nine months ended September 30, 2004 primarily relates to additional costs, net of recoveries, for our exit of the Institutional Research Business toward the end of 2003 and the transfer of our consumer loan operations from Arlington, Virginia to E*TRADE Consumer Finance in Irvine, California.

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NOTE 14 INCOME (LOSS) PER SHARE

The following table is a reconciliation of basic and diluted income per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
BASIC:				
Numerator:				
Income from continuing operations	$ 79,837	$ 62,283	$ 261,027	$ 95,836
Net income (loss) from discontinued operations	(563)	(880)	29,627	(264)
Net income	$ 79,274	$ 61,403	$ 290,654	$ 95,572
Denominator:				
Basic weighted-average shares outstanding	369,103	359,432	366,244	356,762
Per Share:				
Income per share from continuing operations	$ 0.21	$ 0.17	$ 0.71	$ 0.27
Net income (loss) per share from discontinued operations	(0.00)	(0.00)	0.08	(0.00)
Net income per share	$ 0.21	$ 0.17	$ 0.79	$ 0.27
DILUTED:				
Numerator:				
Income from continuing operations	$ 79,837	$ 62,283	$ 261,027	$ 95,836
Interest on convertible subordinated notes, net of tax			17,547	
Income from continuing operations, as adjusted	79,837	62,283	278,574	95,836
Net income (loss) from discontinued operations	(563)	(880)	29,627	(264)
Net income, as adjusted	$ 79,274	$ 61,403	$ 308,201	$ 95,572
Denominator:				
Basic weighted-average shares outstanding	369,103	359,432	366,244	356,762
Effect of dilutive securities:				
Weighted-average options and restricted stock issued to employees	8,759	9,195	10,312	4,995
Weighted-average warrants and contingent shares outstanding	2,695	2,546	2,676	2,546
Shares issuable for assumed conversion of convertible subordinated notes			31,841	
Diluted weighted-average shares outstanding	380,557	371,173	411,073	364,303
Per Share:				
Income per share from continuing operations	$ 0.21	$ 0.17	$ 0.68	$ 0.26
Net income (loss) per share from discontinued operations	(0.00)	(0.00)	0.07	(0.00)
Net income per share	$ 0.21	$ 0.17	$ 0.75	$ 0.26

Excluded from the calculations of diluted income (loss) per share are 10.4 million of common stock shares for the three months ended September 30, 2004 and 45.4 million of common stock shares for the three and nine months ended September 30, 2003, issuable under convertible subordinated notes as the effect of applying the treasury stock method on an if-converted basis would be anti-dilutive.

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The following options to purchase shares of common stock are not included in the computation of diluted income per share because the options exercise price is greater than the average market price of the Company s common stock for the periods stated and, therefore, the effect would be anti-dilutive (in thousands, except exercise price data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Options excluded from computation of diluted income per share	11,939	12,264	10,856	24,093
Exercise price ranges:				
High	$ 58.19	$ 58.19	$ 58.19	$ 58.19
Low	$ 11.21	$ 9.38	$ 12.19	$ 6.81

NOTE 15 REGULATORY REQUIREMENTS

Registered Broker-Dealers

The Company s broker-dealer subsidiaries are subject to the Uniform Net Capital Rule (the Rule) under the Securities Exchange Act of 1934 administered by the SEC, the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD), which requires the maintenance of minimum net capital. E*TRADE Securities, E*TRADE Clearing, E*TRADE Professional Trading and E*TRADE Professional Securities have elected to use the alternative method permitted by the Rule, which requires that they maintain minimum net capital equal to the greater of $250,000 or two percent of aggregate debit balances arising from customer transactions, as defined.

Under the alternative method, a broker-dealer may not repay subordinated borrowings, pay cash dividends or make any unsecured advances or loans to its parent or employees, if such payment would result in net capital of less than 5% of aggregate debit balances or less than 120% of its minimum dollar amount requirement.

The table below summarizes the minimum excess capital requirements for the Company s U.S. broker-dealer subsidiaries (in thousands):

	September 30, 2004		
	Required Net Capital	Net Capital	Excess Net Capital
E*TRADE Securities LLC	$ 250	$ 34,762	$ 34,512
E*TRADE Clearing LLC	43,811	280,255	236,444
Dempsey & Company, LLC	250	6,832	6,582
GVR Company, LLC	1,000	34,275	33,275
Engelman Securities, Inc.	289	2,080	1,791

E*TRADE Professional Trading, LLC	250	1,210	960
E*TRADE Professional Securities, LLC	488	4,345	3,857
VERSUS Brokerage Services (U.S.) Inc.	100	665	565
E*TRADE Global Asset Management, Inc.	531	29,382	28,851
International broker-dealers	31,083	77,896	46,813
Totals	$ 78,052	$ 471,702	$ 393,650

Banking

The Bank is subject to various regulatory capital requirements administered by Federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier I Capital to risk-weighted assets and Tier I Capital to adjusted total assets. As shown in the following table, at September 30, 2004, the most recent date of notification, the Office of Thrift Supervision (OTS) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank s category. At September 30, 2004, management believes that the Bank meets all capital adequacy requirements.

The Bank s required and actual capital amounts and ratios are presented in the table below (dollars in thousands):

	Actual		Required for Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
At September 30, 2004:						
Total Capital to risk-weighted assets	$ 1,474,072	11.24%	>$ 1,048,900	>8.0%	>$ 1,311,125	>10.0%
Tier I Capital to risk-weighted assets	$ 1,431,348	10.92%	>$ 524,450	>4.0%	>$ 786,675	>6.0%
Tier I Capital to adjusted total assets	$ 1,431,348	5.94%	>$ 964,459	>4.0%	>$ 1,205,574	>5.0%
At December 31, 2003:						
Total Capital to risk-weighted assets	$ 1,232,674	11.30%	>$ 872,421	>8.0%	>$ 1,090,526	>10.0%
Tier I Capital to risk-weighted assets	$ 1,194,963	10.96%	>$ 436,211	>4.0%	>$ 654,316	>6.0%
Tier I Capital to adjusted total assets	$ 1,194,963	5.92%	>$ 807,922	>4.0%	>$ 1,009,902	>5.0%

NOTE 16 COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS

Legal Matters

In June 2002, the Company acquired from MarketXT Holdings, Inc. (formerly known as Tradescape Corporation) (Tradescape) certain entities referred to as Tradescape Securities, LLC, Tradescape Technologies, LLC and Momentum Securities, LLC. Numerous disputes have arisen between the parties regarding value and responsibility for various liabilities that were first made apparent following the sale. The parties have been unable to resolve these disputes and have each filed lawsuits. On April 8, 2004, Tradescape filed a complaint in the United States District Court for the Southern District of New York against the Company, certain of its officers and directors and other third parties, including Softbank Finance Corporation and Softbank Corporation, alleging that the defendants acted improperly in preventing plaintiffs from obtaining certain contingent payments and claiming damages of $1.5 billion. On April 9, 2004, the Company filed a complaint in the United States District Court for the Southern District of New York against certain directors and officers of Tradescape seeking declaratory relief and monetary damages in an amount to be proven at trial for defendants fraud in connection with the 2002 sale transaction. The Company believes that Tradescape s claims against it are without merit and intends both to vigorously defend the suit and to fully pursue its own claims described above. The Company is unable to predict the outcome of these actions. Management believes that these actions will not have a material adverse effect on its financial condition, results of operations or cash flows.

In 2003, the Company became involved in litigation relating to the Company s former Israeli joint venture. The E*TRADE Israel venture was closed in 2002, as the Company s partner in the joint venture failed. The dispute arises from the parties claims that certain obligations of each of the parties were not performed, ultimately leading to unspecified damages to the parties. The Company believes that the claims against it are

without merit, has vigorously defended the claims in arbitration, which took place during October 2004, and has asserted its own claims against the other party in arbitration. The Company is unable to predict the decision of the arbitrator in this matter nor is it able to estimate the range of loss or recovery. Management believes that these actions will not have a material adverse effect on its financial condition, results of operations or cash flows.

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In addition to the matters described above, the Company is subject to various legal proceedings and claims that arise in the normal course of business, which the Company believes will not have a material adverse effect on its financial condition, results of operations or cash flows.

Regulatory Matters

The securities and banking industries are subject to extensive regulation under Federal, state and applicable international laws. As a result, the Company is required to comply with many complex laws and rules and its ability to so comply is dependent in part on the establishment and maintenance of a reasonable compliance system. From time to time, the Company has been threatened with, or named as a defendant in, lawsuits, arbitrations and administrative claims involving securities, banking and other matters. The Company is also subject to periodic regulatory audits and inspections. Compliance and trading problems that are reported to regulators, such as the SEC, the NYSE, the NASD or the OTS by dissatisfied customers or others are investigated by such regulators, and may, if pursued, result in formal claims being filed against the Company by customers and/or disciplinary action being taken against the Company by regulators. Any such claims or disciplinary actions that are decided against the Company could harm the Company s business.

Commitments

Loans

In the normal course of business, the Bank makes various commitments to extend credit and incur contingent liabilities that are not reflected in the consolidated balance sheets. The Bank had the following loan commitments at September 30, 2004 (in thousands):

	Fixed Rate	Variable Rate	Total
Commitments to purchase loans:			
Mortgage loans	$ 86,983	$ 154,524	$ 241,507
Other loans	14,193		14,193
Total commitments to purchase loans	$ 101,176	$ 154,524	$ 255,700
Commitments to originate loans:			
Mortgage loans	$ 292,709	$ 81,565	$ 374,274
Other loans	425,520		425,520
Total commitments to originate loans	$ 718,229	$ 81,565	$ 799,794
Commitments to sell mortgage loans	$ 64,408	$ 90,154	$ 154,562

Significant changes in the economy or interest rates may influence the impact that these commitments and contingencies have on the Company in the future.

At September 30, 2004, the Bank had commitments to purchase $0.8 billion and sell $1.2 billion of securities. In addition, the Bank had approximately $1.8 billion of certificates of deposit scheduled to mature in less than one year and $2.8 billion of unfunded commitments to extend credit.

Other

In August 2004, the Company signed an agreement to purchase brokerage accounts from a third party, which closed in October 2004. As part of the agreement, the Company paid a deposit of $3.0 million upon execution and is committed to pay up to $18.0 million in total.

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Guarantees

The Bank provides guarantees to investors purchasing mortgage loans, which are considered standard representations and warranties within the mortgage industry. The primary guarantees include:

Representations that: the mortgage and the mortgage note have been duly executed and each is the legal, valid and binding obligation of the Bank, enforceable in accordance with their respective terms; the mortgage has been duly acknowledged and recorded and is valid; and the mortgage and the mortgage note are not subject to any right of rescission, set-off, counterclaim or defense, including, without limitation, the defense of usury, and no such right of rescission, set-off, counterclaim or defense has been asserted with respect thereto. If these representations prove to be untrue, the Bank guarantees to repurchase the loan and return all loan premium pricing and service release premiums.

Guarantees that should any eligible mortgage loan delivered pay off prior to the receipt of the first payment, the Bank will fully refund the loan premium pricing and service release premium.

Guarantees that should any eligible mortgage loan delivered to an investor pay off after the receipt of the first payment and within one hundred twenty (120) days of the purchase date, the Bank will fully refund the servicing released premium.

Management has determined that the maximum potential liability at September 30, 2004 is $28.0 million, based on all available information. The current carrying amount of the liability recorded at September 30, 2004 is $1.0 million and is considered adequate based upon analyses of historical trends and current economic conditions for these guarantees.

As discussed in Note 10, ETBH raises capital through the formation of trusts, which sell mandatorily redeemable preferred stock in the capital markets. During the 30-year period prior to the redemption of these securities, ETBH guarantees the accrued and unpaid distributions on these securities, as well as the redemption price of the securities and certain costs that may be incurred in liquidating, terminating or dissolving the trusts (all of which would otherwise be payable by the trusts). At September 30, 2004, management estimated that the maximum potential liability under this arrangement was approximately $235.8 million or the total face value of these securities plus dividends that may be unpaid at the termination of the trust arrangement.

NOTE 17 ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The Company enters into derivative transactions to protect against the risk of market price or interest rate movements on the value of certain assets and future cash flows. The Company is also required to recognize certain contracts and commitments as derivatives when the characteristics of those contracts and commitments meet the definition of a derivative as promulgated by SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended.

Fair Value Hedges

Overview of Fair Value Hedges

The Company uses a combination of interest rate swaps, purchased options on forward-starting swaps, caps and floors to offset its exposure to a change in value of certain fixed rate assets. In calculating the effective portion of the fair value hedges under SFAS No. 133, the change in the fair value of the derivative is recognized currently in earnings, as is the change in value of the hedged asset attributable to the risk being hedged. Accordingly, the net difference or hedge ineffectiveness, if any, is recognized currently in the consolidated statements of operations in fair value adjustments of financial derivatives.

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The following table summarizes information related to financial derivatives in fair value hedge relationships (dollars in thousands):

	Notional Amount of Derivative	Fair Value of Derivatives			Weighted-Average			
		Asset	Liability	Net	Pay Rate	Receive Rate	Strike Rate	Remaining Life (Years)
At September 30, 2004:								
Loans:								
Pay fixed-interest rate swaps	$ 115,000	$	$ (106)	$ (106)	3.28%	1.68%	%	2.87
Purchased interest rate forward- starting swaps	123,000	321		321	3.21%	N/A	%	3.01
Total loans	238,000	321	(106)	215	3.24%	1.68%	%	2.94
Mortgage-backed securities (MBS):								
Pay fixed-interest rate swaps	576,000		(10,512)	(10,512)	4.11%	1.64%	%	4.37
Purchased interest rate forward- starting swaps	395,000		(1,903)	(1,903)	3.95%	N/A	%	5.10
Purchased interest rate options:								
Caps	720,000	13,645		13,645	N/A	N/A	6.03%	4.96
Floors	100,000	481		481	N/A	N/A	4.25%	3.00
Forward-starting swaps	430,000	14,260		14,260	N/A	N/A	6.13%	13.45
Total MBS	2,221,000	28,386	(12,415)	15,971	4.04%	1.64%	5.92%	6.39
Investment securities:								
Pay fixed-interest rate swaps	104,885		(3,938)	(3,938)	5.05%	1.64%	%	11.90
Time deposits:								
Purchased interest rate forward- starting swaps	100,000	94		94	%	3.33%	%	3.01
Total fair value hedges	$ 2,663,885	$ 28,801	$ (16,459)	$ 12,342	3.98%	1.83%	5.92%	6.17
At December 31, 2003:								
Loans:								
Pay fixed-interest rate swaps	$ 656,000	$	$ (3,000)	$ (3,000)	2.74%	1.16%	%	2.63
Mortgage-backed securities:								
Pay fixed-interest rate swaps	182,000		(1,672)	(1,672)	4.21%	1.16%	%	7.16
Purchased interest rate options:								
Caps	100,000	4,948		4,948	N/A	N/A	5.87%	6.95
Forward-starting swaps	82,000	3,191		3,191	N/A	N/A	7.05%	14.81
Total MBS	364,000	8,139	(1,672)	6,467	4.21%	1.16%	6.40%	8.83
Investment securities:								
Pay fixed-interest rate swaps	54,000		(1,049)	(1,049)	4.58%	1.15%	%	9.38
Total fair value hedges	$ 1,074,000	$ 8,139	$ (5,721)	$ 2,418	3.15%	1.16%	6.40%	5.07

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De-designated Fair Value Hedges

During 2004 and 2003, certain fair value hedges were de-designated; therefore, hedge accounting was discontinued during those periods for those derivatives. The net gain or loss on those derivative instruments at the time of de-designation is being amortized to interest expense over the original forecasted period of the underlying transactions, being hedged. Changes in the fair value of these derivative instruments after the discontinuance of fair value hedge accounting were recorded in gain on sales of loans held-for-sale and securities, net in the consolidated statements of operations.

Cash Flow Hedges

Overview of Cash Flow Hedges

The Company uses interest rate swaps and caps to hedge the variability of future cash flows associated with existing variable-rate liabilities and forecasted issuances of liabilities. These cash flow hedge relationships are treated as effective hedges as long as the future issuances of liabilities remain probable and the hedges continue to meet the requirements of SFAS No. 133. The Company also enters into interest rate swaps to hedge changes in the future variability of cash flows of certain investment securities resulting from changes in a benchmark interest rate. Additionally, the Company enters into forward purchase and sale agreements, which are considered cash flow hedges, when the terms of the commitments exactly match the terms of the securities purchased or sold.

Changes in the fair value of derivatives that hedge cash flows associated with time deposits, repurchase agreements, advances from the Federal Home Loan Bank (FHLB), dollar rolls and other borrowings and investment securities are reported in AOCI as unrealized gains or losses. The fair value of derivatives in active cash flow hedge relationships decreased by $146 million and $39 million during the three and nine months ended September 30, 2004, respectively. The amounts in AOCI are then included in interest expense as a yield adjustment during the same periods in which the related interest on the fundings or investment securities affect earnings. During the upcoming twelve months, the Company expects to include a pre-tax amount of approximately $30.5 million of net unrealized losses that are currently reflected in AOCI in interest expense as a yield adjustment in the same periods in which the related items affect earnings. The Company expects to hedge the majority of forecasted issuance of liabilities over an eight-to-twelve-year period.

The Company also recognizes cash flow hedge ineffectiveness. Cash flow hedge ineffectiveness is recorded to the extent that the market value of the actual derivatives being hedged outperforms or has a greater increase in market value than a hypothetical derivative, created to match the exact terms of the underlying debt being hedged. The Company recognized this cash flow ineffectiveness in the Statements of Operations as a fair value adjustment of financial derivatives.

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The following table summarizes information related to our financial derivatives in cash flow hedge relationships, hedging variable rate liabilities and the forecasted issuances of liabilities, at September 30, 2004 and December 31, 2003 (dollars in thousands):

	Notional Amount of	Fair Value of Derivative			Weighted-Average			
	Derivative	Asset	Liability	Net	Pay Rate	Receive Rate	Strike Rate	Remaining Life (Years)
At September 30, 2004:								
Pay fixed interest rate swaps:								
Time deposits	$ 300,000	$	$ (1,310)	$ (1,310)	6.79%	1.50%	%	0.10
Repurchase agreements	1,570,000		(26,239)	(26,239)	4.54%	1.80%	%	8.33
Federal Home Loan Bank advances	200,000		(4,310)	(4,310)	4.90%	1.61%	%	10.94
Purchased interest rate forward start swaps:								
Repurchase agreements	975,000		(16,394)	(16,394)	4.81%	N/A	N/A	11.55
Federal Home Loan Bank advances	325,000		(5,671)	(5,671)	4.65%	N/A	N/A	9.40
Purchased interest rate options caps (1)	2,775,000	105,278		105,278	N/A	N/A	4.43%	6.38
Forward purchase and sale agreements	26,907		(28)	(28)	N/A	N/A	N/A	N/A
Total cash flow hedges	$ 6,171,907	$ 105,278	$ (53,952)	$ 51,326	4.85%	1.74%	4.43%	7.70
At December 31, 2003:								
Pay fixed interest rate swaps:								
Time deposits	$ 450,000	$	$ (24,105)	$ (24,105)	6.35%	1.46%	%	1.52
Repurchase agreements	3,488,000	4,091	(46,196)	(42,105)	4.23%	0.80%	%	7.44
Federal Home Loan Bank advances	165,000		(2,409)	(2,409)	3.19%	1.16%	%	2.77
Purchased interest rate options caps (1)	1,000,000	47,322		47,322	N/A	N/A	2.98%	4.47
Forward purchase and sale agreements	335,500		(872)	(872)	N/A	N/A	N/A	N/A
Total cash flow hedges	$ 5,438,500	$ 51,413	$ (73,582)	$ (22,169)	4.42%	0.89%	2.98%	6.18

(1) Purchased interest rate options were used to hedge the Bank s repurchase agreements.

Under SFAS 133, we are required to record the fair value of gains and losses on derivatives designated as cash flow hedges in the AOCI component of shareholders equity. Gains and losses on derivatives designated as fair value hedges are not included in AOCI. In addition, during the normal course of business, the Company terminates certain interest rate swaps and options.

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The following tables shows: 1) amounts recorded in AOCI related to derivative instruments accounted for as cash flow hedges; 2) the notional amounts and fair values of derivatives terminated for the periods presented; and 3) the amortization of terminated interest rate swaps included in interest expense (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Impact on AOCI (net of taxes):				
Beginning balance	$ (27,717)	$ (174,691)	$ (123,754)	$ (188,280)
Gains (losses) on cash flow hedges related to derivatives, net	(114,417)	(898)	(47,748)	(40,792)
Reclassifications to earnings, net	13,974	17,615	43,342	71,098
Balance at September 30	$ (128,160)	$ (157,974)	$ (128,160)	$ (157,974)
Derivatives terminated during the quarter:				
Notional	$ 2,970,000	$ 2,347,000	$ 4,453,500	$ 5,519,500
Fair value of net gains (losses) recognized in AOCI	$ (30,079)	$ 31,720	$ (57,561)	$ (45,921)
Amortization of terminated interest rate swaps included in interest expense	$ (24,522)	$ (31,400)	$ (77,001)	$ (98,339)

The gains (losses) accumulated in AOCI on the derivative instruments terminated shown in the preceding table will be included in interest expense over the periods the hedged forecasted issuance of liabilities will affect earnings, ranging from 1 day to 11.33 years.

The following table represents the balance in AOCI attributable to open cash flow hedges and discontinued cash flow hedges (in thousands):

	At September 30,	
	2004	2003
AOCI balance (net of taxes) related to:		
Open cash flow hedges	$ (45,147)	$ (53,923)
Discontinued cash flow hedges	(83,013)	(104,051)
Total	$ (128,160)	$ (157,974)

Hedge Ineffectiveness

In accordance with SFAS No. 133, the Company recognizes hedge ineffectiveness on both fair value and cash flow hedge relationships. These amounts are reflected in the consolidated statements of operations in fair value adjustments of financial derivatives. The following table summarizes the income (expense) recognized by the Company as fair value and cash flow hedge ineffectiveness (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Fair value hedges	$ (1,015)	$ (2,522)	$ (3,239)	$ (18,271)
Cash flow hedges	1,711	1,524	6,056	2,535
Total	$ 696	$ (998)	$ 2,817	$ (15,736)

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Mortgage Banking Activities

The Company enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding; these commitments are referred to as Interest Rate Lock Commitments, (IRLCs). IRLCs on loans the Bank intends to sell are considered to be derivatives and are, therefore, recorded at fair value with changes in fair value recorded in earnings. For purposes of determining their fair value, the Company performs a net present value analysis of the anticipated cash flows associated with these IRLCs. The net present value analysis excludes the market value associated with the anticipated sale of servicing rights related to each loan commitment. At September 30, 2004, the fair value of these IRLCs was a $1.7 million liability.

IRLCs expose the Company to interest rate risk. The Company manages this risk by selling mortgages or mortgage-backed securities on a forward basis referred to as Forward Sale Agreements. Changes in the fair value of these derivatives are included in the consolidated statements of operations as gain on sales of loans held-for-sale and securities, net or gain on sales of originated loans based on whether the loan was purchased or originated.

Gains (losses) related to the net change in the IRLCs and the related hedging instruments are presented in the following table (in thousands):

	Period Ended September 30,	
	2004	**2003**
Three Months Ended	$ (84)	$ 2,995
Nine Months Ended	$ 3,296	$ 4,784

NOTE 18 SEGMENT INFORMATION

The Company s business results (excluding discontinued operations) are presented as two segments: Brokerage and Banking.

Brokerage includes:

Retail operations both domestic and international

Institutional operations both domestic and international, professional trading, as well as market-making activities

Corporate operations E*TRADE Financial Corporate Services and other operations

Banking includes:

Retail operations mortgage and consumer lending services, FDIC-insured deposit and banking products

Institutional operations global asset management activities

The Company evaluates the performance of its segments based on segment contribution (net revenues less expenses excluding interest). All corporate overhead, administrative and technology charges are allocated to segments either in proportion to their respective direct costs or based upon specific operating criteria.

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Financial information for the Company s reportable segments is presented in the following tables (in thousands):

	Three Months Ended September 30, 2004			
	Brokerage	Banking	Elimi-nation (1)	Total
Commissions	$ 64,005	$	$	$ 64,005
Principal transactions	48,212			48,212
Interest income	42,871	250,141		293,012
Interest expense	(4,795)	(124,057)		(128,852)
Provision for loan losses		(9,145)		(9,145)
Gain on sales of originated loans		12,917		12,917
Gain on sales of loans held-for-sale and securities, net		13,108		13,108
Other revenues	48,541	8,280	(12,941)	43,880
Net revenues	198,834	151,244	(12,941)	337,137
Compensation and benefits	55,892	31,372		87,264
Occupancy and equipment	12,604	6,572		19,176
Communications	16,628	1,837		18,465
Professional services	10,820	6,545		17,365
Commissions, clearance and floor brokerage	30,890	4		30,894
Advertising and market development	5,376	17,797	(12,941)	10,232
Servicing and other banking expenses		9,129		9,129
Fair value adjustments of financial derivatives		(696)		(696)
Depreciation and amortization	16,313	4,444		20,757
Amortization of other intangibles	4,021	2,250		6,271
Facility restructuring and other exit charges	(227)	(4)		(231)
Acquisition-related expenses		62		62
Other	9,332	9,350		18,682
Total expenses excluding interest	161,649	88,662	(12,941)	237,370
Income before other corporate items	$ 37,185	$ 62,582	$	$ 99,767

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	Three Months Ended September 30, 2003			
	Brokerage	Banking	Elimi-nation (1)	Total
Commissions	$ 92,885	$	$	$ 92,885
Principal transactions	64,174			64,174
Interest income	36,883	176,254		213,137
Interest expense	(2,442)	(117,481)		(119,923)
Provision for loan losses		(7,988)		(7,988)
Gain on sales of originated loans		53,308		53,308
Gain on sales of loans held-for-sale and securities, net		32,819		32,819
Other revenues	47,334	11,246	(1,049)	57,531
Net revenues	238,834	148,158	(1,049)	385,943
Compensation and benefits	64,025	41,178		105,203
Occupancy and equipment	14,350	6,177		20,527
Communications	18,431	1,417		19,848
Professional services	8,851	7,508		16,359
Commissions, clearance and floor brokerage	41,425	4		41,429
Advertising and market development	4,617	10,398	(1,049)	13,966
Servicing and other banking expenses	101	9,234		9,335
Fair value adjustments of financial derivatives		998		998
Depreciation and amortization	15,495	4,634		20,129
Amortization of other intangibles	4,445	2,543		6,988
Facility restructuring and other exit charges	30,505	16,493		46,998
Acquisition-related expenses	472	62		534
Other	13,628	15,428		29,056
Total expenses excluding interest	216,345	116,074	(1,049)	331,370
Income before other corporate items	$ 22,489	$ 32,084	$	$ 54,573

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	Nine Months Ended September 30, 2004			
	Brokerage	Banking	Elimi-nation (1)	Total
Commissions	$ 255,391	$	$	$ 255,391
Principal transactions	185,088			185,088
Interest income	127,831	694,753		822,584
Interest expense	(12,049)	(357,567)		(369,616)
Provision for loan losses		(25,701)		(25,701)
Gain on sales of originated loans		61,492		61,492
Gain on sales of loans held-for-sale and securities, net		42,061		42,061
Other revenues	155,834	26,611	(35,279)	147,166
Net revenues	712,095	441,649	(35,279)	1,118,465
Compensation and benefits	177,313	109,309		286,622
Occupancy and equipment	38,959	19,331		58,290
Communications	50,988	5,012		56,000
Professional services	25,436	21,965		47,401
Commissions, clearance and floor brokerage	116,741	6		116,747
Advertising and market development	31,679	52,659	(35,279)	49,059
Servicing and other banking expenses	466	26,113		26,579
Fair value adjustments of financial derivatives		(2,817)		(2,817)
Depreciation and amortization	46,587	15,239		61,826
Amortization of other intangibles	14,024	5,943		19,967
Facility restructuring and other exit charges	(1,005)	(137)		(1,142)
Acquisition-related expenses		186		186
Other	37,688	27,433		65,121
Total expenses excluding interest	538,876	280,242	(35,279)	783,839
Income before other corporate items	$ 173,219	$ 161,407	$	$ 334,626

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	Nine Months Ended September 30, 2003			
	Brokerage	Banking	Elimi- nation (1)	Total
Commissions	$ 239,553	$	$	$ 239,553
Principal transactions	165,024			165,024
Interest income	106,071	545,531		651,602
Interest expense	(6,832)	(356,768)		(363,600)
Provision for loan losses		(26,149)		(26,149)
Gain on sales of originated loans		171,728		171,728
Gain on sales of loans held-for-sale and securities, net		68,974		68,974
Other revenues	134,499	26,947	(1,049)	160,397
Net revenues	638,315	430,263	(1,049)	1,067,529
Compensation and benefits	172,149	122,761		294,910
Occupancy and equipment	48,681	16,619		65,300
Communications	56,114	4,533		60,647
Professional services	25,202	18,963		44,165
Commissions, clearance and floor brokerage	110,047	78		110,125
Advertising and market development	14,430	35,985	(1,049)	49,366
Servicing and other banking expenses	257	30,346		30,603
Fair value adjustments of financial derivatives		15,736		15,736
Depreciation and amortization	54,076	14,779		68,855
Amortization of other intangibles	14,303	6,056		20,359
Facility restructuring and other exit charges	99,736	25,600		125,336
Acquisition-related expenses	1,731	1,125		2,856
Other	45,986	35,404		81,390
Total expenses excluding interest	642,712	327,985	(1,049)	969,648
Income (loss) before other corporate items	$ (4,397)	$ 102,278	$	$ 97,881

(1) Reflects the elimination of an intercompany payment made by the Banking segment to the Brokerage segment related to the Sweep Deposit Account (SDA). Under this relationship, the Banking segment pays the Brokerage segment a negotiated rate that approximates market on the average SDA balance. The Banking segment reflects this payment as marketing expense and the Brokerage segment reflects this payment as other revenue.

	Brokerage	Banking	Elimi- nation	Total
Segment Assets:				
As of September 30, 2004	$ 6,146,951	$ 24,189,773	$	$ 30,336,724
As of December 31, 2003	$ 5,617,188	$ 20,432,028	$	$ 26,049,216

No single customer accounted for greater than 10% of total revenues in the three or nine months ended September 30, 2004 or 2003.

NOTE 19 SUBSEQUENT EVENT

In October 2004, the Company entered into an agreement to purchase a registered investment advisory firm, with over $500 million in assets under management, which provides asset management services and general wealth advice to individuals. The purchase price will be up to approximately $12.0 million and is expected to close in late 2004.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the unaudited Consolidated Financial Statements and the related notes that appear elsewhere in this document.

FORWARD-LOOKING STATEMENTS

Statements made in this document, other than statements of historical information, are forward-looking statements that are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements may sometimes be identified by words such as expect, may, looking forward, we plan, we believe, are planned, could be and currently anticipate. Although we b statements, as well as other oral and written forward-looking statements made by us or on behalf of E*TRADE Financial Corporation from time to time, to be true and reasonable, we can give no assurance that these plans, intentions or expectations will be achieved. Actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements. Important factors that could cause actual results to differ materially from our forward-looking statements are set forth in our other filings with the SEC and in this document under the heading Risk Factors. We caution that the risks and factors discussed below and in such filings are not exclusive. We do not undertake to update any forward-looking statements that may be made from time to time by or on behalf of E*TRADE FINANCIAL.

OVERVIEW

We are a global financial services company offering retail, corporate and institutional customers an integrated and complementary array of trading, investing, banking and lending solutions built around competitive pricing, differentiated functionality and outstanding customer service. Since we offer and deliver our solutions primarily through the Internet and other electronic media, our current and potential customer base is geographically dispersed and we have a lower operating cost structure than traditional brick and mortar financial services companies. During the past two years, we have focused on broadening and integrating our portfolio of financial solutions to deepen our customer relationships and provide a better customer experience. These efforts have led to improved profitability for the Company over the past two years despite a challenging macroeconomic environment and a recent slowdown in the equities market.

The Company intends to continue to seek opportunities to:

- Deepen customer relationships by cross-selling a broader range of financial solutions and growing overall customer assets through acquisitions, improving relationship management, of which our E*TRADE FINANCIAL Center strategy in key metropolitan markets is a component, and providing wealth management services.

- Integrate our business by leveraging our customer relationships and our technology. Leveraging our customer relationships across our segments allows us to optimize our revenues throughout the business and provide more compelling financial solutions to our customers. Leveraging our technology, including our processing and clearing system, which was converted from multiple platforms to ADP in September 2004, allows us to have a more scalable and cost-efficient platform.

The Company intends to increase marketing spend in the next several months, targeting certain customer segments. For these customer segments, the marketing will be focused on increasing customer usage and aggregating customer assets by communicating trading and investing solutions that include improved trading platforms such as Power E*TRADE Pro, 12B-1 fee rebates and low-cost stock index funds, and improved integrated investing and banking solutions.

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The Company recognizes that it faces numerous challenges in responding to the dynamics of the financial services industry, which is characterized by increasingly rapid change, evolving customer demands, and intense competition. The Company has identified certain industry trends, such as:

- Continued competitive pricing pressure on trading commissions within certain customer segments and on consumer loan originations.
- Continued margin compression and low market volatility within market making.
- Continued market uncertainty and macroeconomic factors that could result in volatility in market volumes and trading activity.

Our business results are presented as two segments, Brokerage and Banking. The retail Brokerage business continues to be the primary point of introduction for the majority of our customers and we have added Banking solutions, which complement our Brokerage business. In late 2003, we began lowering our overall cost of funds at the Bank and deepening our customer relationships by sweeping certain Brokerage customer money market and free credit balances into an FDIC-insured Sweep Deposit Account (SDA), which reduced our reliance on other higher cost FDIC-insured deposit accounts including money market accounts and certificates of deposit. Since inception in September 2003, the SDA balance has grown to $5.6 billion, $800 million of which was swept in August 2004, leading to a higher interest rate spread at the Bank.

During the three and nine months ended September 30, 2004, the Brokerage segment generated 55% and 61%, respectively, of the Company s net revenues, while the Banking segment generated 45% and 39%, respectively, of the Company s net revenues.

The Brokerage segment earns a significant amount of its revenues from commissions and margin lending. Of total Brokerage segment revenues, commissions and margin lending represented 34% and 12%, respectively, for the three months ended September 30, 2004 and 38% and 15%, respectively, for the nine months ended September 30, 2004.

- Brokerage Daily Average Revenue Trades (DART s) have slowed in the three months ended September 30, 2004 from the comparable period in 2003. DARTs are higher for the nine months ended September 30, 2004 as compared to 2003, however, driven by strong levels in early 2004. For the three months ended September 30, 2004, our Brokerage commission revenues declined 31%, resulting from the 27% decline in our DARTs and a decrease in our average commission per revenue trade due to pricing initiatives and trade mix. For the nine months ended September 30, 2004, our Brokerage commission revenues increased 7%, resulting from the 13% increase in our DARTs, partially offset by a decrease in our average commission per revenue trade due to pricing initiatives and trade mix.
- Average margin debt increased for the three and nine months ended September 30, 2004 over comparable periods in 2003 by $800 million and $1 billion, respectively. For the three and nine months ended September 30, 2004, Brokerage interest income increased 16% and 21%, respectively, from the comparable periods in 2003, primarily resulting from the increases in average margin debt balances.

The Banking segment earns a significant amount of its revenues in interest on its diversified interest-earning assets (assets held by the Banking segment which earn interest income). Net interest income represented 83% and 76% of total Banking segment revenues, for the three and nine months ended September 30, 2004, respectively.

Net interest income increased 115% and 79% for the three and nine months ended September 30, 2004, from the comparable periods in 2003. As a percentage of total banking revenues, net interest income comprised 83% and 76% for the three and nine months ended September 30, 2004, compared to 40% and 44% for the three and nine months ended September 30, 2003. These increases were due to the combination of increased net interest rate spread and higher average interest-earning assets.

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Net interest rate spread increased 80 basis points and 60 basis points for the three and nine months ended September 30, 2004, respectively, from the comparable periods in 2003. The increase in net interest rate spread for both periods is largely due to our lower cost of funds from sweeping brokerage customer funds and free credits to the SDA over the past year, which replaced higher-rate funds, such as certificates of deposit. The SDA balance has grown to $5.6 billion as of September 30, 2004.

Average interest-earning assets increased $6.3 billion and $5.0 billion, for the three and nine months ended September 30, 2004, respectively, from the comparable periods in 2003. These increases were driven by increases in mortgage-backed and available-for-sale securities, complemented with purchases of a number of home equity lines of credit (HELOC) portfolios.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of our financial results of operations and financial position requires us to make judgments and estimates that may have a significant impact upon the financial results of the Company. We believe that of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management, which can materially impact reported results: allowance for loan losses and uncollectible margin loans, classification and valuation of certain investments, valuation and accounting for financial derivatives, estimates of effective tax rate, deferred taxes and valuation allowances and valuation of goodwill and other intangibles. These are described more fully in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2003.

RESULTS OF OPERATIONS

*Consolidated E*TRADE FINANCIAL Results*

For the three months ended September 30, 2004, our net income was $79.3 million compared to $61.4 million for the three months ended September 30, 2003. For the nine months ended September 30, 2004, our net income was $290.7 million compared to $95.6 million for the nine months ended September 30, 2003. The following sections describe the changes in key operating factors and other changes and events that have affected our consolidated revenues, expenses excluding interest and other income (loss).

Net Revenues

Net revenues (revenues net of brokerage and banking interest expense and provision for loan losses) decreased 13% to $337.1 million for the three months ended September 30, 2004 and increased 5% to $1,118.5 million for the nine months ended September 30, 2004 from the comparable periods in 2003. Brokerage revenues were down overall for the three months ended September 30, 2004, due to lower volumes from that of the three months ended September 30, 2003. Brokerage revenues increased for the nine months due to increased DARTs and higher margin loan balances as a result of a resurgence in trading activity early in the year. Banking revenues increased for the nine months ended September 30, 2004, due to higher interest rate spreads and average interest-earning assets. Higher interest rate spreads were driven primarily by access to lower cost funds from utilizing the SDA product. Higher net interest income was partially offset by reduced revenues from the mortgage and loan sale activity compared to 2003. See the section titled Analysis of Revenues for a detailed discussion about the changes in revenue.

Expenses Excluding Interest

Total expenses excluding interest decreased 28% to $237.4 million for the three months ended September 30, 2004 and 19% to $783.8 million for the nine months ended September 30, 2004 from the comparable periods in 2003. Expenses excluding interest were down overall for the three and nine months ended September 30, 2004, primarily due to lower facility restructuring and other exit charges, as we initiated a new plan in 2003, with only minimal adjustments in 2004.

Total expenses excluding interest for the Brokerage segment, other than facility restructuring and other exit charges, were also down for the three months ended September 30, 2004, from the comparable period in 2003, primarily due to the decline in trading activity. The decline in trading activity lead to lower commissions, clearance, and floor brokerage and lower compensation and benefits, reflecting the variable cost structure for the Brokerage segment.

Total expenses excluding interest for the Banking segment, other than facility restructuring and other exit charges, were also down for the three and nine months ended September 30, due to lower compensation and benefits, primarily reflecting the workforce reductions as a result of the decline in mortgage originations from comparable periods in 2003.

Compensation and benefits decreased 17% to $87.3 million for the three months ended September 30, 2004 and 3% to $286.6 million for the nine months ended September 30, 2004 from the comparable periods in 2003. Overall, as a percentage of total revenues, compensation and benefits expense is consistent with the reduction of revenues for the comparable periods. For the three months ended September 30, 2004, lower compensation and benefits associated with the Brokerage segment is due to lower sales and trader commissions associated with lower trading volumes. Likewise, the increase for the nine months ended September 30, 2004 for the Brokerage segment is driven by higher sales and trader commissions as related brokerage revenue volumes were higher for the nine months ended September 30, 2004 from the comparable period in 2003. The decreases for the Banking segment are due to lower costs associated with the mortgage business, which experienced a significant reduction in revenues in 2004 as compared to 2003.

Commissions, clearance and floor brokerage decreased 25% to $30.9 million for the three months ended September 30, 2004 and increased 6% to $116.7 million for the nine months ended September 30, 2004 from the comparable periods in 2003. The changes reflect volume-driven brokerage-related revenues. In addition, for the nine months ended September 30, 2004, we recorded a one-time termination fee, related to our conversion of our back office to a single platform, of $4.3 million.

Advertising and market development decreased 27% to $10.2 million for the three months ended September 30, 2004 and 1% to $49.1 million for the nine months ended September 30, 2004 from the comparable periods in 2003. The decrease for the three months ended September 30, 2004, for both the Brokerage and Banking segments, is due to a reduction of market spend due to the current market conditions. The decrease for the nine months ended September 30, 2004 is much lower than the three months due to increased advertising spend early in the year.

Other expenses decreased 36% to $18.7 million for the three months ended September 30, 2004 and 20% to $65.1 million for the nine months ended September 30, 2004 from the comparable periods in 2003. The decrease for the Banking segment is primarily due to a $7.2 million expense for the three months ended September 30, 2003 for a litigation matter. The decrease for the Brokerage segment is primarily due to a $7 million expense for the nine months ended September 30, 2003 for a brokerage-related litigation matter.

Other Income (Loss)

Gain (loss) on sale and impairment of investments increased 15% to a gain of $47.2 million for the three months ended September 30, 2004 and 72% to a gain of $107.5 million for the nine months ended September 30, 2004 from the comparable periods in 2003. For the three and nine months ended September 30, 2004, gains were primarily from sales of our shares in SBI. We sold shares of SBI resulting in a gain of $45.4 million and $109.9 million for the three and nine months ended September 30, 2004, respectively. In addition, we recorded an other-than-temporary impairment of approximately $4.4 million during the nine months ended September 30, 2004.

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Loss on early extinguishment of debt was $18.6 million and $23.0 million for the three and nine months ended September 30, 2004, respectively. Loss on early extinguishment of debt was primarily the result of our early redemptions of our 6.00% and 6.75% convertible subordinated notes for cash. The loss recognized is attributed to the premium paid and write-off of unamortized debt issuance costs of $15.1 million. In addition, we paid down $50 million in FHLB advances, resulting in an early termination fee of approximately $2.4 million and an early call of a $24.2 million Floating Rate Junior Subordinated Debenture, resulting in a $1.1 million charge recorded as loss on early extinguishment of debt for the remaining unamortized discount and issuance costs incurred when the debenture was originally issued.

Income Tax Expense (Benefit)

Income tax expense was $38.5 million for the three months ended September 30, 2004, at a tax rate of 32.5% and $25.4 million at a tax rate of 29.0% for the three months ended September 30, 2003. Income tax expense was $129.5 million for the nine months ended September 30, 2004, at a tax rate of 33.1% and $46.3 million for the nine months ended September 30, 2003, at a tax rate of 33.8%. The rate for the three and nine months ended September 30, 2004 decreased primarily due to a tax benefit of a research and development tax credit for which we received a favorable IRS audit result during the nine months ended September 30, 2004 and a tax benefit from our tax basis in a partnership interest that was sold during the nine months ended September 30, 2004.

Analysis of Revenues

Brokerage Revenues

Our brokerage revenues decreased 22% to $185.9 million for the three months ended September 30, 2004 and increased 6% to $676.8 million for the nine months ended September 30, 2004 from the comparable periods in 2003. The decrease for the three months ended September 30, 2004 is primarily due to lower volumes than that of the three months ended September 30, 2003. These volume declines resulted in decreases in commissions, principal transactions and other brokerage-related revenues. The overall increase for the nine months ended September 30, 2004 is due to increased DART volumes and higher margin loan balances as a result of resurgence in trading activity for the year as compared to the nine months ended September 30, 2003.

The components of our net brokerage revenues and percentage change information were as follows (dollars in thousands):

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2004	2003	$ Amount	%	2004	2003	$ Amount	%
Brokerage revenues:								
Commissions	$ 64,005	$ 92,885	$ (28,880)	(31)%	$ 255,391	$ 239,553	$ 15,838	7 %
Principal transactions	48,212	64,174	(15,962)	(25)%	185,088	165,024	20,064	12 %
Other brokerage-related revenues	35,600	46,285	(10,685)	(23)%	120,555	133,450	(12,895)	(10)%
Brokerage interest income	42,871	36,883	5,988	16 %	127,831	106,071	21,760	21 %
Brokerage interest expense	(4,795)	(2,442)	(2,353)	(96)%	(12,049)	(6,832)	(5,217)	(76)%

Net brokerage revenues	$ 185,893	$ 237,785	$ (51,892)	(22)%	$ 676,816	$ 637,266	$ 39,550	6 %

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Other key criteria that we use to measure performance and explain the results of our brokerage operations are presented in the following table:

	Three Months Ended September 30,		Percentage	Nine Months Ended September 30,		Percentage
	2004	2003	Change	2004	2003	Change
Total revenue trades	6,233,826	8,417,615	(26)%	23,870,859	21,057,053	13 %
Daily average revenue trades (DART s)	97,404	132,561	(27)%	126,973	112,304	13 %
Average commission per revenue trade	$ 10.27	$ 11.03	(7)%	$ 10.70	$ 11.38	(6)%
Average (dollars in millions):						
Customer margin balances	$ 2,043	$ 1,240	65 %	$ 2,052	$ 1,083	89 %
Customer money market fund balances	$ 8,160	$ 7,621	7 %	$ 8,033	$ 7,429	8 %
Stock borrow balances	$ 1,073	$ 436	146 %	$ 1,056	$ 374	182 %
Stock loan balances	$ 1,270	$ 701	81 %	$ 1,266	$ 583	117 %
Customer credit balances	$ 2,140	$ 2,168	(1)%	$ 2,435	$ 1,916	(27)%

We earn brokerage commissions when customers execute trades. Average commission per revenue trade varies based on the number of trades and types of trades a customer makes during the quarter. During the first quarter of 2004, we launched Priority E*TRADE, creating a third tier in our retail price structure, offering lower commission rates for qualified customers of $12.99 per trade from $22.99 per trade. The changes in commission revenues were driven by both the change in DARTs and average commission per revenue trade. Average commission per revenue trade decreased in both the three and nine months ended September 30, 2004, as compared to the prior periods, due to the pricing impact of Priority E*TRADE. Although less significant than the pricing initiative, the change in trade mix within our retail business and between retail and professional, which has a lower commission structure, also contributed to the change in average commission per revenue trade.

Principal transactions include institutional revenues, market-making revenues and net proprietary trading gains. The decrease for the three months is due to decreased institutional, market-making and net proprietary trading gains. The increase for the nine months ended September 30, 2004 from the comparable periods in 2003 is due to increased market-making revenues, primarily from increased volume of bulletin board stocks, and increased institutional revenues and net proprietary trading gains.

Other brokerage-related revenues include account maintenance fees, payments for order flow from outside market makers, stock plan administration products and services revenue, electronic communication network (ECN) rebate revenues, proprietary fund revenues and fees for brokerage-related services. The decreases for the three and nine months ended September 30, 2004 from the comparable periods in 2003, are primarily related to decreases in account maintenance fees of $2.4 million and $10.1 million, proprietary fund revenues of $2.6 million and $6.0 million, IRA fees of $1.2 million and $3.2 million, respectively and for both periods decreases in ECN rebate revenues of $2.4 million. These decreases were slightly offset by increases in payments for order flow of $0.3 million and $4.4 million and stock plan administration product and services revenue of $0.8 million and $2.2 million, for the three and nine months ended September 30, 2004 from the comparable periods in 2003, respectively.

Brokerage interest income includes interest earned on margin loans, regulatory cash and investments and stock borrow balances, as well as fees on customer assets invested in money market accounts. The increase for the three and nine months ended September 30, 2004 from the comparable periods in 2003, was primarily due to increased revenue earned on margin debt and increased stock borrow revenue, offset by decreased revenue earned on customer money market fund balances swept to the Bank and decreased revenue earned on lower customer segregated balances.

Brokerage interest expense includes interest paid to customers on certain credit balances and interest paid to banks and interest paid to other broker-dealers through our stock loan program. The increase for the three and

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nine months ended September 30, 2004 from the comparable periods in 2003 was due to an overall increase in average stock loan balances.

Banking Revenues

Our banking revenues increased 2% to $151.2 million during the three months ended September 30, 2004 and 3% to $441.6 million, during the nine months ended September 30, 2004 compared to the same periods in 2003. Net banking interest income rose during both the three and nine months ended September 30, 2004 primarily because of significant increases in net interest rate spread. The increase in net interest rate spread, in turn, reflects the access of up to $5.6 billion of lower cost funds since the September 2003 introduction of the SDA product, as well as increases in average interest-earning assets. The rise in net interest income was partially offset by reduced revenues from mortgage and loan sale activity from the comparable periods in 2003.

The components of our net banking revenues and percentage change information were as follows (dollars in thousands):

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2004	2003	$ Amount	%	2004	2003	$ Amount	%
Banking revenues:								
Banking interest income	$ 250,141	$ 176,254	$ 73,887	42 %	$ 694,753	$ 545,531	$ 149,222	27 %
Banking interest expense	(124,057)	(117,481)	(6,576)	(6)%	(357,567)	(356,768)	(799)	
Provision for loan losses	(9,145)	(7,988)	(1,157)	(14)%	(25,701)	(26,149)	448	2 %
Gain on sales of originated loans	12,917	53,308	(40,391)	(76)%	61,492	171,728	(110,236)	(64)%
Gain on sales of loans held for sale and securities, net	13,108	32,819	(19,711)	(60)%	42,061	68,974	(26,913)	(39)%
Other banking related revenues	8,280	11,246	(2,966)	(26)%	26,611	26,947	(336)	(1)%
Net banking revenues	$ 151,244	$ 148,158	$ 3,086	2 %	$ 441,649	$ 430,263	$ 11,386	3 %

Banking interest income is earned from interest-earning banking assets (primarily loans receivable and mortgage-backed securities). Several factors affect interest income, including the volume, price, mix and maturity of interest-earning assets; the use of derivative instruments to manage interest rate risk; market rate fluctuations; and asset quality. Average interest-earning assets increased during 2004 from increases in the average balances of mortgage-backed and available-for-sale securities, complemented with purchases of a number of HELOC portfolios. These increases in average interest-earning assets drove increases in banking interest income during the three months and nine months ended September 30, 2004 of $73.9 million and $149.2 million, respectively, over the same periods in 2003.

Banking interest expense is incurred through interest-bearing banking liabilities, including customer deposits, advances from the FHLB and other borrowings. Banking liabilities grew during the three and nine months ended September 30, 2004 over the same periods last year, reflecting the continuing growth of the SDA, which was introduced in mid-2003. This increase was partially offset by a decline in higher interest rate transactional accounts. Largely because of these changes in the composition of the Bank s portfolio of interest-bearing banking liabilities, interest cost declined by 63 basis points during the three months ended September 30, 2004 and 67 basis points during the nine months ended September 30, 2004, from the comparable periods in 2003.

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Banking interest income and Banking interest expense both reflect income and expense on hedges that qualify for hedge accounting under SFAS No. 133. The following table shows the income (expenses) on hedges that are included in Banking interest income and Banking interest expense for the three and nine months ended September 2004 and 2003 (in thousands):

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2004	2003	$ Amount	%	2004	2003	$ Amount	%
Banking interest income:								
Banking interest income, gross	$ 255,002	$ 183,005	$ 71,99739	39%	$ 705,229	$ 578,199	$ 127,030	22 %
Hedge expense	(4,861)	(6,751)	1,890	28%	(10,476)	(32,668)	22,192	68 %
Banking interest income, net of hedges	250,141	176,254	73,887	42 %	694,753	545,531	149,222	27 %
Banking interest expense:								
Banking interest expense, gross	(74,744)	(74,836)	92	%	(198,911)	(231,554)	32,643	14 %
Hedge expense	(49,313)	(42,645)	(6,668)	(16)%	(158,656)	(125,214)	(33,442)	(27)%
Banking interest expense, net of hedges	(124,057)	(117,481)	(6,576)	(6)%	(357,567)	(356,768)	(799)	%
Net interest income	$ 126,084	$ 58,773	$ 67,311	115 %	$ 337,186	$ 188,763	$ 148,423	79 %

Net interest spread increased to 213 basis points for the three months ended September 30, 2004 from 133 basis points for the comparable period in 2003 and increased to 202 basis points for the nine months ended September 30, 2004 from 142 basis points for the comparable period in 2003. The increases for both periods in 2004 were primarily driven by a lower overall cost of funding. We continue to see economic benefits from the SDA where we swept additional funds during 2004, growing our total SDA balance by $1.3 billion during the first nine months of the year to a balance of $5.6 billion at September 30, 2004.

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The following tables present average balance, income and expense data, related interest yields and rates, and net interest spread for the three and nine months ended September 30, 2004 and 2003 (dollars in thousands):

	Three Months Ended September 30, 2004			Three Months Ended September 30, 2003		
	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost
Interest-earning banking assets:						
Loans receivable, net (1)	$ 10,305,473	$ 124,835	4.85%	$ 7,431,318	$ 85,768	4.62%
Interest-bearing deposits	110,136	963	3.48%	337,595	1,573	1.85%
Mortgage-backed and related available-for-sale securities	8,579,174	86,137	4.02%	6,545,038	63,462	3.88%
Available-for-sale investment securities	3,314,544	33,981	4.10%	2,033,425	22,118	4.35%
Investment in FHLB stock	100,460	882	3.49%	79,236	649	3.25%
Trading securities	681,326	5,528	3.24%	410,976	3,244	3.16%
Total interest-earning banking assets (2)	23,091,113	$ 252,326	4.37%	16,837,588	$ 176,814	4.20%
Non-interest-earning banking assets	419,246			933,232		
Total banking assets	$ 23,510,359			$ 17,770,820		
Interest-bearing banking liabilities:						
Retail deposits	$ 11,516,741	$ 41,042	1.42%	$ 9,032,367	$ 62,975	2.77%
Brokered certificates of deposit	378,241	2,381	2.50%	345,357	2,175	2.50%
FHLB advances	1,117,619	12,732	4.46%	849,147	11,661	5.37%
Other borrowings	9,038,526	67,902	2.94%	5,983,488	40,670	2.66%
Total interest-bearing banking liabilities	22,051,127	$ 124,057	2.24%	16,210,359	$ 117,481	2.87%
Non-interest bearing banking liabilities	346,631			605,868		
Total banking liabilities	22,397,758			16,816,227		
Total banking shareholder s equity	1,112,601			954,593		
Total banking liabilities and shareholder s equity	$ 23,510,359			$ 17,770,820		
Excess of interest-earning banking assets over interest-bearing banking liabilities/net interest income	$ 1,039,986	$ 128,269		$ 627,229	$ 59,333	
Net interest spread			2.13%			1.33%
Net interest margin (net yield on interest-earning banking assets)			2.22%			1.41%
Ratio of interest-earning banking assets to interest-bearing banking liabilities			104.72%			103.87%

Return on average: (3) (4)		
Total banking assets	0.83%	0.84%
Total banking shareholder s equity	17.53%	15.69%
Average equity to average total banking assets	4.73%	5.37%

(1) Nonaccrual loans are included in the respective average loan balances. Income on such nonaccrual loans is recognized on a cash basis.

(2) Includes a taxable equivalent increase in interest income of $2.2 million for the three months ended September 30, 2004 and $0.6 million for the three months ended September 30, 2003.

(3) Ratio calculations exclude discontinued operations.

(4) Ratio calculated based on standalone Bank results and not segment results.

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	Nine Months Ended September 30, 2004			Nine Months Ended September 30, 2003		
	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost
Interest-earning banking assets:						
Loans receivable, net (1)	$ 9,523,482	$ 346,666	4.85%	$ 7,340,106	$ 282,584	5.13%
Interest-bearing deposits	122,141	3,089	3.38%	215,752	3,512	2.18%
Mortgage-backed and related available-for-sale securities	8,055,147	241,896	4.00%	6,557,295	185,487	3.77%
Available-for-sale investment securities	2,958,567	87,133	3.93%	1,933,368	63,092	4.35%
Investment in FHLB stock	93,488	2,459	3.51%	79,779	2,353	3.94%
Trading securities	756,926	18,146	3.20%	388,072	10,165	3.49%
Total interest-earning banking assets (2)	21,509,751	$ 699,389	4.34%	16,514,372	$ 547,193	4.41%
Non-interest-earning banking assets	479,059			857,309		
Total banking assets	$ 21,988,810			$ 17,371,681		
Interest-bearing banking liabilities:						
Retail deposits	$ 11,681,921	$ 132,845	1.52%	$ 8,567,247	$ 204,521	3.19%
Brokered certificates of deposit	369,877	6,996	2.53%	406,260	8,405	2.77%
FHLB advances	1,002,062	33,598	4.41%	937,497	30,986	4.36%
Other borrowings	7,546,832	184,128	3.21%	6,036,669	112,856	2.47%
Total interest-bearing banking liabilities	20,600,692	$ 357,567	2.32%	15,947,673	$ 356,768	2.99%
Non-interest bearing banking liabilities	323,384			550,796		
Total banking liabilities	20,924,076			16,498,469		
Total banking shareholder s equity	1,064,734			873,212		
Total banking liabilities and shareholder s equity	$ 21,988,810			$ 17,371,681		
Excess of interest-earning banking assets over interest-bearing banking liabilities/net interest income	$ 909,059	$ 341,822		$ 566,699	$ 190,425	
Net interest spread			2.02%			1.42%
Net interest margin (net yield on interest-earning banking assets)			2.12%			1.54%
Ratio of interest-earning banking assets to interest-bearing banking liabilities			104.41%			103.55%
Return on average: (3) (4)						
Total banking assets			0.81%			0.73%

Total banking shareholder s equity	16.83%	14.48%
Average equity to average total banking assets	4.84%	5.03%

(1) Nonaccrual loans are included in the respective average loan balances. Income on such nonaccrual loans is recognized on a cash basis.
(2) Includes a taxable equivalent increase in interest income of $4.6 million for the nine months ended September 30, 2004 and $1.7 million for the nine months ended September 30, 2003.
(3) Ratio calculations exclude discontinued operations
(4) Ratio calculated based on standalone Bank results and not segment results.

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Gain on sales of originated loans includes gains on loans made by E*TRADE Mortgage and E*TRADE Consumer Finance. As shown in the following table, gain on sales of originated loans declined during both the three and nine month periods primarily because of reductions in the volume of direct mortgage loan originations resulting from rising interest rates in 2004, contrasted with declining interest rates in 2003 (dollars in thousands):

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2004	**2003**	**$ Amount**	**%**	**2004**	**2003**	**$ Amount**	**%**
Mortgage loans	$ 10,933	$ 53,095	$ (42,162)	(79)%	$ 54,429	$ 169,233	$ (114,804)	(68)%
Consumer loans	1,984	213	1,771	*	7,063	2,495	4,568	183 %
Total	$ 12,917	$ 53,308	$ (40,391)	(76)%	$ 61,492	$ 171,728	$ (110,236)	(64)%

* Not meaningful.

Gain on sales of loans held-for-sale and securities, net represents net gains from the sales of loans that the Company intended to sell within one year, as well as gains from the sales of securities sold by the Bank. The following table presents the net gains that the Company earned from the sales of loans held-for-sale and securities (dollars in thousands):

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2004	**2003**	**$ Amount**	**%**	**2004**	**2003**	**$ Amount**	**%**
Gain on sales of securities, net:								
Gain on sales of securities	$ 27,364	$ 34,371	$ (7,007)	(20)%	$ 63,237	$ 65,584	$ (2,347)	(4)%
Impairment	(12,424)		(12,424)	*	(18,335)	(31)	(18,304)	*
Gain on hedges				%		1,906	(1,906)	(100)%
Gain on sales of securities, net	14,940	34,371	(19,431)	(57)%	44,902	67,459	(22,557)	(33)%
Gain (loss) on sales of loans held-for-sale, net:								
Gain (loss) on sales of loans held-for-sale	1,610	(4,257)	5,867	*	5,159	33,891	(28,732)	(85)%
Gain (loss) on hedges	(3,201)	4,975	(8,176)	*	(6,774)	(23,134)	16,360	71 %
Loss on loan prepayments	(241)	(2,270)	2,029	89 %	(1,226)	(9,242)	8,016	87 %
Gain (loss) on sales of loans held-for-sale, net	(1,832)	(1,552)	(280)	(18)%	(2,841)	1,515	(4,356)	*
Total	$ 13,108	$ 32,819	$ (19,711)	(60)%	$ 42,061	$ 68,974	$ (26,913)	(39)%

* Not meaningful.

Gain on sales of securities, net decreased during the three months ended September 30, 2004, primarily because of a $24.5 million decline in the gain from sales of interest-only securities and a $12.4 million other-than-temporary impairment in the value of asset-backed, mortgage-backed and interest-only securities recognized during the three months ended September 30, 2004. These declines were partially offset by an increase of $17.5 million in the gain from sales of mortgage-backed and investment securities. During the nine months ended September 30, 2004, the Company recognized $18.3 million of other-than-temporary impairment on the fair value of securities, while a minimal impairment was recognized for the nine months ended September 30, 2003. In addition, the gains that the Company recognized from the sales of securities during the nine months ended September 30, 2004 declined $4.3 million, from the results achieved during the same period in 2003.

The gain (loss) on sales of loans held-for-sale, net during the three and nine months ended September 30, 2004, declined from the prior years results primarily because of a rise in interest rates, which lowered the volume of correspondent loan sales and securitizations. These results reflect the partially offsetting gains (losses)

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on hedges, which the Company entered into to protect against the impact of changes in interest rates on market prices and future cash flows. The rise in interest rates in 2004 also produced a reduction in the loss that the Bank incurred from loan prepayments.

Other banking-related revenues include credit card, servicing and other banking fees imposed on deposit and transactional accounts and management fees. During the three and nine months ended September 30, 2004, portfolio management fees earned by a Bank subsidiary decreased $2.6 million and $8.0 million, respectively, from the same periods last year. The decrease during the nine month period was offset by a $2.5 million increase in credit card fees, resulting from increases in the size of the Bank s credit card portfolio, a $3.8 million improvement in the level of servicing impairments recognized by the Bank and a $1.4 million increase in other banking and management fees.

Provision for loan losses was $9.1 million and $8.0 million for the three months ended September 30, 2004 and 2003, respectively, and was $25.7 million and $26.1 million for the nine months ended September 30, 2004 and 2003, respectively. The 14% increase in the Company s provision for loan losses during the three months ended September 30, 2004 primarily reflects the provision for loan losses for HELOC portfolios that were acquired during the three months ended September 30, 2004.

Allowance for loan losses is an accounting estimate of credit losses inherent in the Bank s loan portfolio. Consistent with our existing policy, management believes the allowance for loan losses at September 30, 2004, is at least equal to the probable losses inherent in the Bank s loan portfolio as of September 30, 2004, which will emerge over the next twelve months. The following table presents the allowance for loan losses by major loan category. This allocation does not necessarily prevent the Company from shifting the allowance for loan losses between categories to better align the allowance for loan losses with the actual performance of the portfolio (dollars in thousands):

	Consumer [1]		Real Estate and Home Equity [2]		Total	
	Allowance	**Allowances as % of consumer loans held-for-investment**	**Allowance**	**Allowances as % of real estate loans held-for-investment**	**Allowance**	**Allowances as % of total loans held-for-investment**
September 30, 2004	$ 29,855	0.71%	$ 13,039	0.21%	$ 42,894	0.41%
June 30, 2004	$ 30,299	0.71%	$ 10,639	0.20%	$ 40,938	0.43%
March 31, 2004	$ 31,889	0.77%	$ 7,862	0.19%	$ 39,751	0.48%
December 31, 2003	$ 32,185	0.75%	$ 5,662	0.15%	$ 37,847	0.46%
September 30, 2003	$ 30,680	0.71%	$ 3,328	0.14%	$ 34,008	0.50%

(1) Primarily RV, automobile, marine and credit card loans.
(2) Primarily one-to-four family mortgage and home equity loans.

The allowance for loan losses increased $8.9 million, or 26.1% from $34.0 million at September 30, 2003 to $42.9 million at September 30, 2004, primarily due to an increase in the level of purchase loan portfolios included in the Company s held-for-investment portfolio. Management s estimates regarding probable losses inherent in the Bank s real estate loan portfolio are based largely on the condition of the real estate market during the third quarter of 2004.

Delinquent, Nonperforming and Other Problem Assets

We continually monitor our loan portfolio to anticipate and address potential and actual delinquencies. Based on the length of the delinquency period, we reclassify these assets as nonperforming and, if necessary, take possession of the underlying collateral. Once we take possession of the underlying collateral, we classify the property as other assets on our consolidated balance sheets.

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Nonperforming Assets. We classify loans as nonperforming whenever principal or interest payments are more than 90 days past due or when we have reason to believe the loan is uncollectible. When a loan is classified as nonperforming, we: 1) stop recognizing interest income on the loan; 2) reverse any interest accrued during the initial 90-day period; and 3) discontinue the accretion of deferred loan fees. Whenever we receive a payment from a nonperforming loan, we apply the full payment to principal if we continue to doubt that both principal and interest will be collected in full. We only recognize payments as interest income when we expect the principal and interest to be collected in full or when the principal has been fully repaid.

Repossessed Assets and Nonperforming Loans. When we acquire the collateral underlying uncollectible loans, we record this Real Estate Owned (REO) and other repossessed assets at estimated fair value, less estimated selling costs. We use appraisals and other appropriate valuation methods to estimate the fair value of these assets. If the net estimated fair value of the collateral is less than the loan balance, the difference is charged to the allowance for loan losses. We perform periodic valuations and establish a valuation allowance for REO and repossessed assets through a charge to income if the carrying value of a property exceeds its estimated fair value less estimated selling costs.

The following table presents information about our nonperforming assets (in thousands):

	September 30, 2004	December 31, 2003
Real estate loans	$ 11,606	$ 18,363
Consumer and other loans	6,304	6,231
Total nonperforming loans, net	17,910	24,594
REO and other repossessed assets, net	4,770	6,690
Total nonperforming assets, net	$ 22,680	$ 31,284
Total nonperforming assets, net, as a percentage of total bank assets	0.09%	0.15%
Total allowance for loan losses as a percentage of total nonperforming loans, net	239.50%	153.89%

During the nine months ended September 30, 2004, our nonperforming assets decreased by $8.6 million, or 28% from the $31.3 million balance at December 31, 2003, primarily due to the continued seasoning of our real estate loans. During 2004, we recognized $0.7 million of interest on nonperforming loans. If our nonperforming loans at September 30, 2004 had been performing in accordance with their terms, we would have recorded approximately $0.3 million of additional interest income during the third quarter of 2004.

Liquidity and Capital Resources

In addition to our cash flows from operations, we have historically met our liquidity needs primarily through investing and financing activities, consisting principally of equity and debt offerings, increases in core deposit accounts, other borrowings and sales of loans or securities. We believe that we will be able to renew or replace our funding sources at prevailing market rates, which may be higher or lower than current rates, as well as to supplement these funding sources with cash flow from operations.

Cash Provided by Operating Activities

Cash provided by operating activities from continuing operations was $0.9 billion for the nine months ended September 30, 2004 and 2003. For the nine months ended September 30, 2004, cash provided by operating activities increased due to higher net income, net of gain on the sale of E*TRADE Access and gains on sales of investments, changes in brokerage and banking-related assets, offset by changes in income taxes and other assets and liabilities.

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Rising interest rates in 2004 led to a decline in the volume of loans originated and the associated net proceeds from loan sales during the nine months ended September 30, 2004, from the comparable period in 2003. In addition, these rising rates led to a decline in loans held-for-sale in the consolidated balance sheets during the first nine months of 2004. During the nine months ended September 30, 2004, the net proceeds from trading securities increased by $0.6 million primarily reflecting declines in trading securities, partially offset by a slightly lower decline in the proceeds from the sales, repayments and maturities of these securities.

Cash Used in Investing Activities

Cash used in investing activities from continuing operations was $4.5 billion for the nine months ended September 30, 2004 and $1.9 billion for the comparable period in 2003. Cash used in investing activities increased due to higher net purchases of mortgage-backed and investment securities, available-for-sale and a net increase in loans receivable, offset by proceeds from the sale of E*TRADE Access.

Available-for-sale mortgage-backed and investment securities increased in the consolidated balance sheets during the first nine months of 2004, primarily because of the Company s increased investments in mortgage-backed securities of U.S. Government-sponsored enterprises.

Cash Provided by Financing Activities

Cash provided by financing activities from continuing operations was $3.4 billion for the nine months ended September 30, 2004 and $1.2 billion for the comparable period in 2003. For the nine months ended September 30, 2004, cash provided by financing activities increased due to net increases in securities sold under agreements to repurchase, advances from the Federal Home Loan Bank and other borrowed funds of $6.1 billion and issuance in June 2004 of 8.00% senior notes for net proceeds of $394 million, offset by net decreases in banking deposits of $3.6 billion, repurchases of our common stock of $120 million and principal payments on our convertible subordinated notes of $429 million. For the nine months ended September 30, 2003, cash flows from increases in banking deposits was approximately $3.1 billion primarily due to the initial sweep of funds into the SDA. Additional funds were swept in 2004, but were offset by decreases in higher-cost deposit accounts. The sources for the principal payments on our convertible subordinated notes were from the net proceeds of our issuance of the 8.00% senior notes and cash from our Board approved repurchase plan. As of September 30, 2004, our remaining authorized amount to repurchase additional shares of our common stock or repayment of additional debt, under the Board approved plan is approximately $93.9 million.

Other Sources of Liquidity

We rely on borrowed funds, such as FHLB advances and securities sold under agreements to repurchase to provide liquidity for the Bank. At September 30, 2004, the Bank had additional borrowing capacity of approximately $5.9 billion. At September 30, 2004, we have financing facilities totaling $400 million to meet the needs of E*TRADE Clearing. These facilities, if used, may be collateralized by customer securities. There was $31.2 million outstanding as of September 30, 2004 and no amounts outstanding as of December 31, 2003. We also have multiple loans collateralized by equipment owned by us, for which $32.8 million was outstanding as of September 30, 2004. We have also financed the purchase of fixed assets under capital leases, with an outstanding balance of $0.3 million at September 30, 2004. In addition, we have entered into numerous agreements with other broker-dealers to provide financing under our stock loan program.

Other Liquidity Matters

We currently anticipate that our available cash resources and credit will be sufficient to meet our current anticipated working capital and capital expenditure requirements for at least the next 12 months. We may need to raise additional funds in order to support more rapid expansion, develop new or enhanced products and services, respond to competitive pressures, acquire complementary businesses or technologies and/or take advantage of unanticipated opportunities.

RISK FACTORS

RISKS RELATING TO THE NATURE OF THE FINANCIAL SERVICES BUSINESS

Many of our competitors have greater financial, technical, marketing and other resources

We face direct competition from retail and institutional financial service companies in each of our lines of business. Many of our competitors have longer operating histories and greater resources than we do and offer a wider range of financial products and services. Many also have greater name recognition, greater market acceptance and larger customer bases. These competitors may conduct extensive promotional activities and offer better terms, lower prices and/or different products and services to customers than we do. Moreover, some of our competitors have established relationships among themselves or with third parties to enhance their products and services. This means that our competitors may be able to respond more quickly to new or changing opportunities and demands and withstand changing market conditions better than we can.

Downturns or disruptions in the securities markets could reduce transaction volumes and margin borrowing and increase our dependence on our more active customers who receive lower prices

A significant portion of our revenues in recent years has been from online investing services, and although we continue to diversify our revenue sources, we expect this business to continue to account for a significant portion of our revenues in the foreseeable future. Like other financial services firms, we are affected directly by national and global economic and political conditions, broad trends in business and finance, disruptions to the securities markets and changes in volume and price levels of securities and futures transactions.

A decrease in transaction volume may be more significant for us with respect to our less active customers, increasing our dependence on our more active and professional trading customers who receive more favorable pricing based on their transaction volume. Decreases in volumes, as well as securities prices, are also typically associated with a decrease in margin borrowing. Because we generate revenue from interest charged on margin borrowing, such decreases result in a reduction of revenue to E*TRADE Clearing. When transaction volume is low, our operating results may be harmed in part because some of our overhead costs may remain relatively fixed.

Downturns in the securities markets increase the credit risk associated with margin lending or stock loan transactions

We permit customers to purchase securities on margin. When the market declines rapidly, there is an increased risk that the value of the collateral we hold in connection with these transactions could fall below the amount of a customer s indebtedness. Similarly, as part of our broker-dealer operations, we frequently enter into arrangements with other broker-dealers for the lending of various securities. Under regulatory guidelines, when we borrow or lend securities, we must generally simultaneously disburse or receive cash deposits. We may risk losses if there are sharp changes in market values of many securities and the counterparties to the borrowing and lending transactions fail to honor their commitments. Any downturn in public equity markets may lead to a greater risk that parties to stock lending transactions may fail to meet their commitments.

We may be unsuccessful in managing the effects of changes in interest rates and the interest-bearing assets in our portfolio

The results of operations for the Bank depend in large part upon its level of net interest income, that is, the difference between interest income from interest-earning assets (such as loans and mortgage-backed and other asset-backed securities) and interest expense on interest-bearing liabilities (such as deposits and borrowings). The Bank uses derivatives to help manage its interest rate risk. However, derivatives utilized may not be entirely effective and changes in market interest rates and the yield curve could reduce the value of the Bank s financial assets and reduce net interest income. Many factors affect interest rates, including governmental monetary policies and domestic and international economic and political conditions.

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The Bank s diversification of its asset portfolio may increase the level of charge-offs

As the Bank diversifies its asset portfolio through purchases and originations of higher-yielding asset classes, such as automobile, marine and recreational vehicle loans and credit card portfolios, we will have to manage assets that carry a higher risk of default than our mortgage portfolio. Consequently, the level of charge- offs associated with these assets may be higher than previously experienced. In addition, if the overall economy weakens, we could experience higher levels of charge-offs. If expectations of future charge-offs increase, a corresponding increase in the amount of our allowance for loan loss would be required. The increased level of provision for loan losses recorded to meet additional allowance for loan loss requirements could adversely affect our financial results if those higher yields do not cover the provision for loan losses.

An increase in our delinquency rate could adversely affect our results of operations

Our underwriting criteria or collection methods may not afford adequate protection against the risks inherent in the loans comprising our consumer loan portfolio. In the event of a default, the collateral value of the financed item may not cover the outstanding loan balance and costs of recovery. In the event our portfolio of consumer finance receivables experiences higher delinquencies, foreclosures, repossessions or losses than anticipated, our results of operations or financial condition could be adversely affected.

Risks associated with principal trading transactions could result in trading losses

A majority of our specialist and market-making revenues at Dempsey are derived from trading by Dempsey as a principal. Dempsey may incur trading losses relating to the purchase, sale or short sale of securities for its own account, as well as trading losses in its specialist stocks and market maker stocks. From time to time, Dempsey may have large positions in securities of a single issuer or issuers engaged in a specific industry. Dempsey also operates a proprietary trading desk separately from its specialist and market maker operations, which may also incur trading losses.

Certain portions of our professional business are also involved in proprietary trading, in which the firm provides capital that becomes traded by employees and others. Similar to Dempsey s business, the proprietary trading positions of E*TRADE Professional may also incur trading losses.

Reduced grants by companies of employee stock options could adversely affect our results of operations

E*TRADE Financial Corporate Services is a provider of stock plan administration and options management tools. The FASB has proposed that companies value and expense stock options they grant to their employees and employee stock purchase plan transactions in which the terms are more favorable to those available to all holders of the same class of shares beginning in 2005. This proposal may result in companies granting fewer employee options and modifying their existing employee stock purchase plans, potentially reducing the amount of products and services we provide these companies and compelling us to incur additional costs so that our tools comply with the proposed FASB statement. Additionally, we may see a reduction in commission revenues as fewer options would be available for exercise and sale by the employees of these companies.

Reduced spreads in securities pricing, levels of trading activity and trading through market makers and/or specialists could harm our specialist and market maker business

The increase in computer generated buy/sell programs in the marketplace has continued to tighten spreads, resulting in reduced revenue capture per share by the specialist and market-making community and reduced payment for order flow revenues for us. Similarly, a reduction in the volume and/or volatility of trading activity could also reduce spreads that specialists and market makers receive, also adversely affecting revenues generated by Dempsey.

Alternative trading systems that have developed over the past few years could also reduce the levels of trading of exchange-listed securities through specialists and the levels of over-the-counter trading through market

makers. In addition, ECNs have emerged as an alternative forum to which broker-dealers and institutional investors can direct their limit orders. This allows broker-dealers and institutional investors to avoid directing their trades through market makers. As a result, Dempsey may experience a reduction in its flow of limit orders.

If we do not successfully manage consolidation opportunities, we could be at a competitive disadvantage

There has been significant consolidation in the online financial services industry over the last several years, and the consolidation is likely to continue in the future. Should we fail to take advantage of viable consolidation opportunities or if we overextend our efforts by acquiring businesses that we are unable to integrate or manage properly, we could be placed at a competitive disadvantage. Acquisitions entail numerous risks including retaining or hiring skilled personnel, integrating acquired operations, products and personnel and the diversion of management attention from other business concerns. In addition, there can be no assurance that we will realize a positive return on any acquisition or that future acquisitions will not be dilutive to earnings.

We rely heavily on technology to deliver products and services

Disruptions to or instability of our technology, including an actual or perceived breach of the security of our technology, could harm our business and our reputation.

Our international efforts subject us to additional risks and regulation, which could impair our business growth

One component of our strategy has been an effort to build an international business. We have established certain joint venture and/or licensee relationships. We have limited control over the management and direction of these venture partners and/or licensees, and their action or inaction, including their failure to follow proper practices with respect to regulatory compliance and/or corporate governance, could harm our operations and/or our reputation.

RISKS RELATING TO THE REGULATION OF OUR BUSINESS

We are subject to extensive government regulation, including banking and securities rules and regulations, which could restrict our business practices

The securities and banking industries are subject to extensive regulation. All of our broker-dealer subsidiaries have to comply with many laws and rules, including rules relating to possession and control of customer funds and securities, margin lending and execution and settlement of transactions. We are also subject to additional laws and rules as a result of our specialist and market maker operations in Dempsey.

To the extent that, now or in the future, we solicit orders from our customers or make investment recommendations (or are deemed to have done so), or offer products and services, such as investing in futures, that are not suitable for all investors, we would become subject to additional rules and regulations governing, among other things, sales practices and the suitability of recommendations to customers.

As part of our Institutional business we provide clients access to certain third-party research tools and other services in exchange for commissions earned. Currently, these activities are allowed by various regulatory bodies, however, changes have been proposed in the United Kingdom and the United States that may limit or eliminate altogether the services we could provide to clients in exchange for commissions. If these proposals are adopted, we may realize a decrease in our institutional commission revenues.

Similarly, E*TRADE Financial Corporation, E*TRADE Re, LLC and ETBH, as savings and loan holding companies, and E*TRADE Bank, as a Federally chartered savings bank, are subject to extensive regulation, supervision and examination by the OTS, and, in the case of the Bank, the FDIC. Such regulation covers all banking business, including lending practices, safeguarding deposits, capital structure, recordkeeping, transactions with affiliates and conduct and qualifications of personnel.

If we fail to comply with applicable securities, banking and insurance laws, rules and regulations, we could be subject to disciplinary actions, damages, penalties or restrictions that could significantly harm our business

The SEC, NYSE, NASD, Commodity Futures Trading Commission or other self-regulatory organizations and state securities commissions can, among other things, censure, fine, issue cease-and-desist orders or suspend or expel a broker-dealer or any of its officers or employees. The OTS may take similar action with respect to our banking activities. Similarly, the attorneys general of each state could bring legal action on behalf of the citizens of the various states to ensure compliance with local laws. The ability to comply with applicable laws and rules is dependent in part on the establishment and maintenance of a reasonable compliance system. The failure to establish and enforce reasonable compliance procedures, even if unintentional, could subject us to significant losses or disciplinary or other actions.

If we do not maintain the capital levels required by regulators, we may be fined or even forced out of business

The SEC, NYSE, NASD, OTS and various other regulatory agencies have stringent rules with respect to the maintenance of specific levels of net capital by securities broker-dealers and regulatory capital by banks. Net capital is the net worth of a broker or dealer (assets minus liabilities), less deductions for certain types of assets. Failure to maintain the required net capital could result in suspension or revocation of registration by the SEC and suspension or expulsion by the NYSE and/or NASD, and could ultimately lead to the firm s liquidation. In the past, our broker-dealer subsidiaries have depended largely on capital contributions by us in order to comply with net capital requirements. If such net capital rules are changed or expanded, or if there is an unusually large charge against net capital, operations that require an intensive use of capital could be limited. Such operations may include investing activities, marketing and the financing of customer account balances. Also, our ability to withdraw capital from brokerage subsidiaries could be restricted, which in turn could limit our ability to repay debt and redeem or purchase shares of our outstanding stock. See Note 15 for the minimum net capital requirements for our domestic broker-dealer subsidiaries for the current reporting period.

Similarly, the Bank is subject to various regulatory capital requirements administered by the OTS. Failure to meet minimum capital requirements can trigger certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could harm a bank s operations and financial statements. A bank must meet specific capital guidelines that involve quantitative measures of a bank s assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. A bank s capital amounts and classification are also subject to qualitative judgments by the regulators about the strength of components of its capital, risk weightings of assets, off-balance sheet transactions and other factors.

Quantitative measures established by regulation to ensure capital adequacy require a bank to maintain minimum amounts and ratios of Total and Tier 1 Capital to risk-weighted assets and of Tier I Capital to adjusted total assets. To satisfy the capital requirements for a well capitalized financial institution, a bank must maintain higher Total and Tier 1 Capital to risk-weighted assets and Tier I Capital to adjusted total assets ratios. See Note 15 for the Bank for the current reporting period.

As a non-grandfathered savings and loan holding company, we are subject to regulations that could restrict our ability to take advantage of certain business opportunities

We are required to file periodic reports with the OTS and are subject to examination by the OTS. The OTS also has certain types of enforcement powers over the Company, ETBH and E*TRADE Re, LLC, including the ability to issue cease-and-desist orders, force divestiture of the Bank and impose civil and monetary penalties for violations of Federal banking laws and regulations or for unsafe or unsound banking practices. In addition, under the Gramm-Leach-Bliley Act, our activities are restricted to those that are financial in nature and certain real estate-related

activities. We may make merchant banking investments in companies whose activities are not financial in nature if those investments are made for the purpose of appreciation and ultimate resale of the

investment and we do not manage or operate the company. Such merchant banking investments may be subject to maximum holding periods and special recordkeeping and risk management requirements.

We believe all of our existing activities and investments are permissible under the Gramm-Leach-Bliley Act, but the OTS has not yet fully interpreted these provisions. Even if our existing activities and investments are permissible, we are unable to pursue future activities that are not financial in nature. We are also limited in our ability to invest in other savings and loan holding companies.

In addition, the Bank is subject to extensive regulation of its activities and investments, capitalization, community reinvestment, risk management policies and procedures and relationships with affiliated companies. Acquisitions of and mergers with other financial institutions, purchases of deposits and loan portfolios, the establishment of new Bank subsidiaries and the commencement of new activities by Bank subsidiaries require the prior approval of the OTS, and in some cases the FDIC, which may deny approval or limit the scope of our planned activity. These regulations and conditions could place us at a competitive disadvantage in an environment in which consolidation within the financial services industry is prevalent. Also, these regulations and conditions could affect our ability to realize synergies from future acquisitions, could negatively affect us following the acquisition and could also delay or prevent the development, introduction and marketing of new products and services.

RISKS RELATING TO OWNING OUR STOCK

We have incurred losses in the past and we cannot assure you that we will be profitable

We have incurred losses in prior periods and we may do so in the future. While we reported net income for the three and nine months ended September 30, 2004 and for the year ended 2003, we reported a net loss of $186.4 million for the year ended December 31, 2002.

We are substantially restricted by the terms of our senior notes

In June 2004, we completed a private offering of an aggregate principal amount of $400 million of senior notes due June 2011. The indenture governing the senior notes contains various covenants and restrictions that limit our ability and certain of our subsidiaries ability to, among other things:

- incur additional indebtedness;
- create liens;
- pay dividends or make other distributions;
- repurchase or redeem capital stock;

- make investments or other restricted payments;
- enter into transactions with our stockholders or affiliates;
- sell assets or shares of capital stock of our subsidiaries;
- restrict dividend or other payments to us from our subsidiaries; and
- merge, consolidate or transfer substantially all of our assets.

As a result of the covenants and restrictions contained in the indenture, we are limited in how we conduct our business and we may be unable to raise additional debt or equity financing to compete effectively or to take advantage of new business opportunities. The terms of any future indebtedness we may incur could include more restrictive covenants.

We cannot assure you that we will be able to remain in compliance with these covenants in the future and, if we fail to do so, that we will be able to obtain waivers from the appropriate parties and/or amend the covenants.

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Our corporate debt requires us to make interest payments and repay the principal at maturity and, as a result, our corporate debt levels may limit our ability to obtain additional financing.

At September 30, 2004, we had an outstanding balance of $185.2 million in convertible subordinated notes and $400.0 million in senior notes. Our ratio of debt (our senior and convertible debt, capital lease obligations and term loans) to equity (expressed as a percentage) was 29% at September 30, 2004. We may incur additional indebtedness in the future. The level of our indebtedness, among other things, could:

- make it more difficult to make payments on our debt;
- make it more difficult or costly for us to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes;
- limit our flexibility in planning for, or reacting to, changes in our business; and
- make us more vulnerable in the event of a downturn in our business.

The market price of our common stock may continue to be volatile

From January 1, 2003 through September 30, 2004, the price per share of our common stock has ranged from a high of $15.40 to a low of $3.65. The market price of our common stock has been, and is likely to continue to be, highly volatile and subject to wide fluctuations. In the past, volatility in the market price of a company s securities has often led to securities class action litigation. Such litigation could result in substantial costs to us and divert our attention and resources, which could harm our business. Declines in the market price of our common stock or failure of the market price to increase could also harm our ability to retain key employees, reduce our access to capital and otherwise harm our business.

We may need additional funds in the future, which may not be available and which may result in dilution of the value of our common stock

In the future, we may need to raise additional funds, which may not be available on favorable terms, if at all. If adequate funds are not available on acceptable terms, we may be unable to fund our business growth plans. In addition, if funds are available, the issuance of securities could dilute the value of shares of our common stock and cause the market price to fall.

We have various mechanisms in place that may discourage takeover attempts

Certain provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a third party from acquiring control of us in a merger, acquisition or similar transaction that a shareholder may consider favorable. Such provisions include:

- authorization for the issuance of blank check preferred stock;
- provision for a classified Board of Directors with staggered, three-year terms;
- the prohibition of cumulative voting in the election of directors;
- a super-majority voting requirement to effect business combinations or certain amendments to our certificate of incorporation and bylaws;
- limits on the persons who may call special meetings of shareholders;
- the prohibition of shareholder action by written consent; and
- advance notice requirements for nominations to the Board of Directors or for proposing matters that can be acted on by shareholders at shareholder meetings.

Attempts to acquire control of the Company may also be delayed or prevented by our stockholder rights plan, which is designed to enhance the ability of our Board of Directors to protect shareholders against

unsolicited attempts to acquire control of the Company that do not offer an adequate price to all shareholders or are otherwise not in the best interests of the Company and our shareholders. In addition, certain provisions of our stock incentive plans, management retention and employment agreements (including severance payments and stock option acceleration), and Delaware law may also discourage, delay or prevent someone from acquiring or merging with us.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For quantitative and qualitative disclosures about market risk, we have evaluated such risks for our Brokerage and Banking segments separately. The following discussion about our market risk disclosure includes forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of certain factors, including, but not limited to, those set forth in the section entitled Risk Factors.

CORPORATE OPERATIONS

Interest Rate Risk

At September 30, 2004, we had variable-rate loans outstanding of approximately $32.8 million and $17.2 million at December 31, 2003. The monthly interest payments on these term loans are subject to interest rate risk. If market interest rates were to have increased immediately and uniformly by 100 basis points at September 30, 2004 and December 31, 2003, the interest payments would have increased by an immaterial amount.

Equity Security Price Risk

We currently hold an investment in SBI which is a Japanese yen denominated publicly traded equity security with a carrying value of $104.6 million and a gross unrealized gain of $88.2 million as of September 30, 2004. As the security s market price and the value of the yen fluctuates, we are exposed to risk of a loss of some or all of the unrealized gains.

BROKERAGE OPERATIONS

Equity Security Price Risk

At September 30, 2004 and December 31, 2003, we held equity security inventories in both listed and OTC securities on both a long and short basis of $26.2 million long, $3.0 million short and $11.6 million long and $4.4 million short, respectively, as part of our market-making, specialist and professional trading operations. A hypothetical 10% increase or decrease in the equities market would not have a material impact on the Company s results of operations because the absolute value of either long or short inventory is not material and changes in value of short

inventory would partially offset changes in value in long inventory.

BANKING OPERATIONS

The Bank s exposure to market risk is dependent upon the distribution of all interest-sensitive assets, liabilities and derivatives. These items have differing risk characteristics that, if properly managed, can mitigate the Bank s exposure to fluctuations in interest rates. At September 30, 2004, approximately 44% of the market value of the Bank s total assets was comprised of residential mortgages and mortgage-backed securities. The values of these assets are sensitive to changes in interest rates, as well as expected prepayment levels. The Bank s liability structure consists primarily of transactional deposit relationships, such as money market accounts, shorter-term certificates of deposit and wholesale-collateralized borrowings from the FHLB and other entities. The derivative portfolio of the Bank is positioned to decrease the overall market risk resulting from the combination of assets and liabilities. The Bank s market risk is discussed and quantified in more detail in the Scenario Analysis section below.

Most of the Bank s assets are generally classified as non-trading portfolios and, as such, are not marked-to-market through earnings for accounting purposes. The Bank did maintain a trading portfolio of investment-grade securities at September 30, 2004 and December 31, 2003. The fair value of the trading portfolio was $625 million at September 30, 2004 and $821 million at December 31, 2003.

Scenario Analysis

Scenario analysis is an advanced approach to estimating interest rate risk exposure. Under the Net Present Value of Equity (NPVE) approach, the present value of all existing assets, liabilities, derivatives and forward commitments are estimated and then combined to produce a NPVE figure. The sensitivity of this value to changes in interest rates is then determined by applying alternative interest rate scenarios, which include, but are not limited to, instantaneous parallel shifts up 100, 200 and 300 basis points and down 100 basis points. The down 200 and 300 basis point scenarios are not presented at September 30, 2004 and December 31, 2003, because they result in negative interest rates.

The sensitivity of NPVE at September 30, 2004 and December 31, 2003 and the limits established by the Bank s Board of Directors are listed below (dollars in thousands):

Parallel Change in Interest Rates (bps)	Change in NPVE				
	September 30, 2004		December 31, 2003		Board Limit
+300	$ (57,412)	(4)%	$ (278,901)	(26)%	(55)%
+200	$ (12,278)	(1)%	$ (175,696)	(16)%	(30)%
+100	$ 24,162	2 %	$ (76,145)	(7)%	(15)%
-100	$ (164,595)	(11)%	$ 18,418	2 %	(15)%

Under criteria published by the OTS, the Bank s overall interest rate risk exposure at September 30, 2004 was characterized as minimum.

Mortgage Production Activities

In the production of mortgage products, the Bank is exposed to interest rate risk between the commitment and funding dates of the loans. There were $0.4 billion at September 30, 2004 and $0.3 billion at December 31, 2003 in mortgage loan commitments awaiting funding. The associated interest rate risk results when the Bank enters into IRLCs, whereby determination of loan interest rates occurs prior to funding. When the intent is to sell originated loans, the associated IRLCs are considered derivatives and, accordingly, are recorded at fair value with associated changes recorded in earnings.

ITEM 4. EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

(a) Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of the Company s disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 (Exchange Act) Rules 13a-15(e) or 15d-15(e)) as of the end of the

period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

(b) Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL AND ADMINISTRATIVE PROCEEDINGS

The Company hereby incorporates by reference the information set forth in Part I of this report under Note 16 of Notes to Unaudited Condensed Consolidated Financial Statements.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In 2003 and 2004, the Company s Board of Directors approved the following Repurchase Plans, as they determined that the use of cash to reduce outstanding debt and outstanding common stock was likely to create long-term value for its shareholders.

2003 Repurchase Plan

On December 9, 2003, the Company s Board of Directors approved and the Company announced, a new $100 million repurchase program (the 2003 Plan). The 2003 Plan was open-ended and provided the flexibility to buy back common stock, retire debt or a combination of both. On April 29, 2004, the Company announced that it had completed the 2003 Plan. From December 9, 2003 through April 29, 2004, the Company s common stock closing price ranged from $10.46 to $15.15. For the nine months ended September 30, 2004, the Company had repurchased shares, all from unrelated third parties and in the open market, as follows:

Month	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of the Plan	Maximum Dollar Value of Shares That May Yet be Purchased Under the Plan
January 2004	747,000	$ 14.17	747,000	$ 89,415,010
February 2004	1,032,000	$ 14.07	1,032,000	$ 74,894,770
March 2004	1,971,000	$ 12.59	1,971,000	$ 50,079,880
April 2004	4,105,000	$ 12.20	4,105,000	$ 1,868
Total	7,855,000	$ 12.73	7,855,000	$ 1,868

2004 Repurchase Plan

On April 29, 2004, the Company announced that its Board of Directors approved a $200 million repurchase program (the 2004 Plan). The 2004 Plan is open-ended and provides the flexibility to buy back common stock, redeem for cash its outstanding convertible subordinated notes, retire debt in the open market or a combination of all three. For the nine months ended September 30, 2004, the Company used $86,242,934 in cash for a partial redemption of its 6.75% convertible subordinated notes. This amount includes premiums of $2.8 million paid above the principal. The Company paid an equivalent premium percentage to all noteholders. From April 29, 2004 through September 30, 2004, the Company s common stock closing price ranged from $9.73 to $12.27. For the nine months ended September 30, 2004, the Company repurchased shares, all from unrelated third parties and in the open market, as follows:

Month	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of the 2004 Plan	Maximum Dollar Value of Shares That May Yet be Purchased Under the 2004 Plan
July 2004	330,000	$ 10.75	330,000	$ 110,209,425
August 2004	978,700	$ 10.96	978,700	$ 99,479,445
September 2004	462,500	$ 11.97	462,500	$ 93,945,236
Total	1,771,200	$ 11.19	1,771,200	$ 93,945,236

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Exercise of warrants

During the nine months ended September 30, 2004, the Company authorized the issuance of an aggregate of 139,440 shares, of Company common stock in connection with the exercise of certain warrants to purchase shares of the Company s common stock, which were assumed in connection with the Company s acquisition of the Bank. These warrants were exercised for $1.82 per share of the Company s common stock. No underwriters were involved and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES NOT APPLICABLE

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

10.64	Form of Employment dated September 1, 2004, by and between the Company and each of Mitchell H. Caplan, R. Jarrett Lilien, Arlen W. Gelbard, Louis Klobuchar, Joshua Levine, Robert J. Simmons and Russell S. Elmer
10.65	Code of Conduct
31.1	Rule 13a-14a/15d-14(a) Certification of Mitchell H. Caplan
31.2	Rule 13a-14a/15d-14(a) Certification of Robert J. Simmons
32.1	Section 1350 Certification of Mitchell H. Caplan and Robert J. Simmons

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 5, 2004

E*TRADE Financial Corporation

(Registrant)

By: /s/ MITCHELL H. CAPLAN

Mitchell H. Caplan

Chief Executive Officer

By: /s/ ROBERT J. SIMMONS

Robert J. Simmons

Chief Financial Officer

(Principal Financial and Accounting Officer)