

E TRADE FINANCIAL CORP
Form 10-K/A
March 24, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Mark One)

x **AMENDMENT NO. 1 TO THE ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005.**

or

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.**

Commission file number 1-11921

E*TRADE Financial Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction)

of incorporation or organization)

94-2844166
(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)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class

Common Stock \$0.01 par value

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Mandatory Convertible Notes

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasonal issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act. Yes No

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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes No

At June 30, 2005, the aggregate market value of voting stock, comprised of the registrant's common stock and shares exchangeable into common stock, held by nonaffiliates of the registrant was approximately \$4.8 billion (based upon the closing price for shares of the registrant's common stock as reported by the New York Stock Exchange on that date.) Shares of common stock held by each officer, director and holder of 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Number of shares outstanding of the registrant's common stock as of February 21, 2006: 417,911,092

Explanatory Note

We are filing this Amendment No. 1 on Form 10-K/A solely to correct a typographical error in the independent registered public accountants report on our internal control over financial reporting. The typographical error was an inadvertent omission of a paragraph in the Reports of Independent Registered Public Accounting Firm contained in Item 8. Financial Statements and Supplementary Data of our original Annual Report on Form 10-K filed on March 3, 2006 (Original Report). There are no changes to the financial or supplemental information contained in Item 8. This Amendment relates solely to the Reports of Independent Registered Public Accounting Firm.

In order to comply with certain technical requirements of the SEC's rules in connection with the filing of this amendment on Form 10-K/A, we are including in this amendment the complete text of Item 8. We are also including in this amendment updated certifications of our principal executive and principal financial officers and an updated Consent of Independent Registered Public Accounting Firm.

This Amendment No. 1 to our Annual Report on Form 10-K as originally filed on March 3, 2006 continues to speak as of the date of our Original Report, and we have not updated the disclosures contained in this Amendment No. 1 to reflect any events that occurred at a date subsequent to the filing of the Original Report.

Item 8. Financial Statements and Supplementary Data

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of E*TRADE Financial Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. E*TRADE Financial Corporation's internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of published financial statements. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

E*TRADE Financial Corporation's management assessed the effectiveness of its internal control over financial reporting as of December 31, 2005. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. Based on our assessment we believe that, as of December 31, 2005, E*TRADE Financial Corporation's internal control over financial reporting is effective based on those criteria.

E*TRADE Financial Corporation's audited consolidated financial statements include the results of the following entities, but management's assessment does not include an assessment of the internal control over financial reporting of these entities because they were acquired during the fourth quarter of 2005. This approach is consistent with published SEC guidance on the permissible scope of management's internal control report.

The U.S.-based online discount brokerage business of *Harrisdirect*, LLC, which was acquired on October 6, 2005; and

The online discount brokerage business of J.P. Morgan Invest, LLC (*BrownCo*), which was acquired on November 30, 2005.

These entities represented 13% of total assets at December 31, 2005 and 3% of revenues for year ended December 31, 2005.

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E*TRADE Financial Corporation's Independent Registered Public Accounting Firm, Deloitte & Touche LLP, has issued an audit report on our assessment of the E*TRADE Financial Corporation's internal control over financial reporting. The report of Deloitte & Touche LLP appears on the next page.

REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

E*TRADE Financial Corporation

Arlington, Virginia

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting, that E*TRADE Financial Corporation and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in the report on Internal Control Over Financial Reporting, management excluded from their assessment the internal control over financial reporting at Harrisdirect, LLC and BrownCo, which were acquired on October 6, 2005 and November 30, 2005, respectively, and whose financial statements represented 13% of total assets at December 31, 2005 and 3% of revenues for 2005. Accordingly, our audit did not include the internal control over financial reporting at Harrisdirect, LLC and BrownCo. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective

internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2005 of the Company and our report dated March 1, 2006 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

McLean, Virginia

March 1, 2006

To the Board of Directors and Stockholders of

E*TRADE Financial Corporation

Arlington, Virginia

We have audited the accompanying consolidated balance sheets of E*TRADE Financial Corporation and subsidiaries (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of E*TRADE Financial Corporation and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 1, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

McLean, Virginia

March 1, 2006

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

	December 31,	
	2005	2004
ASSETS		
Cash and equivalents	\$ 844,188	\$ 939,906
Cash and investments required to be segregated under Federal or other regulations	610,174	724,026
Brokerage receivables, net	7,174,175	3,034,548
Trading securities	146,657	593,245
Available-for-sale mortgage-backed and investment securities (includes securities pledged to creditors with the right to sell or repledge of \$11,792,684 at December 31, 2005 and \$10,113,049 at December 31, 2004)	12,564,738	12,543,818
Loans receivable (net of allowance for loan losses of \$63,286 at December 31, 2005 and \$47,681 at December 31, 2004)	19,424,895	11,505,755
Loans held-for-sale, net	87,371	279,280
Property and equipment, net	299,256	302,291
Derivative assets	152,477	115,867
Accrued interest receivable	183,814	117,131
Investment in Federal Home Loan Bank stock	198,700	92,005
Goodwill	2,003,456	395,043
Other intangibles, net	532,108	134,121
Other assets	345,677	255,547
Total assets	\$ 44,567,686	\$ 31,032,583
LIABILITIES AND SHAREHOLDERS' EQUITY		
Brokerage payables	\$ 7,315,659	\$ 3,618,892
Deposits	15,948,015	12,302,974
Securities sold under agreements to repurchase	11,101,542	9,897,191
Other borrowings by Bank subsidiary	4,166,592	1,760,732
Derivative liabilities	38,072	52,208
Senior notes	1,401,947	400,452
Mandatory convertible notes	435,589	
Convertible subordinated notes	185,165	185,165
Accounts payable, accrued and other liabilities	575,545	586,767
Total liabilities	41,168,126	28,804,381
Shareholders' equity:		
Preferred stock, shares authorized: 1,000,000; issued and outstanding: none at December 31, 2005 and 2004		
Shares exchangeable into common stock, \$0.01 par value, shares authorized: 10,644,223; issued and outstanding: None at December 31, 2005 and 1,302,801 at December 31, 2004		13
Common stock, \$0.01 par value, shares authorized: 600,000,000; issued and outstanding: 416,582,164 at December 31, 2005 and 369,623,604 at December 31, 2004	4,166	3,696
Additional paid-in capital	2,990,676	2,234,093
Deferred stock compensation		(18,419)
Retained earnings	580,430	150,018
Accumulated other comprehensive loss	(175,712)	(141,199)
Total shareholders' equity	3,399,560	2,228,202
Total liabilities and shareholders' equity	\$ 44,567,686	\$ 31,032,583

See accompanying notes to consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

	Year Ended December 31,		
	2005	2004	2003
Revenues:			
Commissions	\$ 458,834	\$ 431,638	\$ 422,709
Principal transactions	99,336	126,893	107,601
Gain on sales of loans and securities, net	98,858	140,718	247,654
Service charges and fees	135,314	97,575	110,058
Other revenues	94,419	89,077	86,514
Interest income	1,650,264	1,145,597	892,832
Interest expense	(779,164)	(510,455)	(486,129)
Net interest income	871,100	635,142	406,703
Provision for loan losses	(54,016)	(38,121)	(38,523)
Net interest income after provision for loan losses	817,084	597,021	368,180
Total net revenues	1,703,845	1,482,922	1,342,716
Expenses excluding interest:			
Compensation and benefits	380,803	350,440	364,598
Occupancy and equipment	69,089	69,572	78,381
Communications	82,485	69,674	73,650
Professional services	75,237	67,747	55,716
Commissions, clearance and floor brokerage	140,806	129,696	124,868
Advertising and market development	105,935	62,155	57,887
Servicing and other banking expenses	52,326	35,971	37,575
Fair value adjustments of financial derivatives	4,892	(2,299)	15,338
Depreciation and amortization	74,981	77,892	85,615
Amortization of other intangibles	43,765	19,443	24,758
Facility restructuring and other exit activities	(30,017)	15,688	134,187
Other	53,751	91,144	101,042
Total expenses excluding interest	1,054,053	987,123	1,153,615
Income before other income, income taxes, minority interest, discontinued operations and cumulative effect of accounting change	649,792	495,799	189,101
Other income:			
Corporate interest income	11,043	6,692	6,550
Corporate interest expense	(73,956)	(47,525)	(45,596)
Gain on sale and impairment of investments	83,144	128,111	147,874
Loss on early extinguishment of debt		(22,972)	
Equity in income of investments and venture funds	6,103	4,382	9,132
Total other income	26,334	68,688	117,960
Income before income taxes, minority interest and discontinued operations	676,126	564,487	307,061
Income tax expense	229,823	181,764	111,601

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Minority interest in subsidiaries	65	893	(5,061)
Net income from continuing operations	446,238	381,830	200,521
Discontinued operations, net of tax:			
Gain (loss) from discontinued operations, net	(21,495)	(32,755)	2,506
Gain on disposal of discontinued operations, net	4,023	31,408	
Net income (loss) from discontinued operations	(17,472)	(1,347)	2,506
Cumulative effect of accounting change, net of tax	1,646		
Net income	\$ 430,412	\$ 380,483	\$ 203,027
<u>Basic income per share</u>			
Basic income per share from continuing operations	\$ 1.20	\$ 1.04	\$ 0.56
Basic income (loss) per share from discontinued operations	(0.04)	(0.00)	0.01
Basic income per share from cumulative effect of accounting change	0.00		
Basic net income per share	\$ 1.16	\$ 1.04	\$ 0.57
<u>Diluted income per share</u>			
Diluted income per share from continuing operations	\$ 1.16	\$ 0.99	\$ 0.55
Diluted income (loss) per share from discontinued operations	(0.04)	(0.00)	0.00
Diluted income per share from cumulative effect of accounting change	0.00		
Diluted net income per share	\$ 1.12	\$ 0.99	\$ 0.55
Shares used in computation of per share data:			
Basic	371,468	366,586	358,320
Diluted	384,630	405,389	367,361

See accompanying notes to consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Year Ended December 31,		
	2005	2004	2003
Net income	\$ 430,412	\$ 380,483	\$ 203,027
Other comprehensive income (loss):			
Available-for-sale securities:			
Unrealized gains, net	12,946	71,488	187,012
Less impact of realized gains (transferred out of AOCI) and included in net income, net	(77,858)	(127,236)	(142,016)
Net change from available-for-sale securities	(64,912)	(55,748)	44,996
Cash flow hedging instruments:			
Unrealized gains (losses), net	7,032	(51,137)	(21,173)
Amortization of losses into interest expense related to de-designated cash flow hedges deferred in AOCI, net	40,155	56,873	85,699
Net change from cash flow hedging instruments	47,187	5,736	64,526
Foreign currency translation gains (losses)	(16,788)	(1,210)	31,958
Other comprehensive income (loss)	(34,513)	(51,222)	141,480
Comprehensive income	\$ 395,899	\$ 329,261	\$ 344,507

See accompanying notes to consolidated financial statements.

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in thousands)

	Shares Exchangeable into					Accumulated			
	Common Stock		Common Stock		Additional Paid-in Capital	Deferred Stock Compensation	Retained Earnings (Deficit)	Other Comprehensive Loss	Total Shareholders Equity
	Shares	Amount	Shares	Amount					
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							203,027		203,027
Other comprehensive income								141,480	141,480
Exercise of stock options and warrants, including tax benefit			8,543	85	58,917				59,002
Employee stock purchase plan			1,572	16	5,908				5,924
Adjustment related to change in original option grants					954				954
Cancellation of unvested restricted stock			(3,447)	(34)	(21,271)	21,305			
Issuance of restricted stock			1,733	17	13,491	(13,408)			100
Amortization of deferred stock compensation, net of cancellations and retirements			(50)		(269)	2,287			2,018
Conversion of Exchangeable Shares to common stock	(241)	(2)	241	2					
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							380,483		380,483
Other comprehensive loss								(51,222)	(51,222)
Exercise of stock options and purchase plans, including tax benefit			6,757	68	57,686				57,754
Employee stock purchase plan			1,443	14	8,640				8,654
Adjustment related to change in original option grants					224				224
Repurchases of common stock			(13,664)	(137)	(175,639)				(175,776)
Cancellation of restricted stock			(113)	(1)	(858)	859			
Issuance of restricted stock			908	9	11,149	(11,058)			100
Shares issued upon debt conversion			7,438	74	79,889				79,963
Amortization of deferred stock compensation, net of cancellations and retirements			(25)		(325)	4,654			4,329
Conversion of Exchangeable Shares to common stock	(83)	(1)	83	1					
Other			161	2	5,397				5,399
Balance, December 31, 2004	1,303	\$ 13	369,624	\$ 3,696	\$ 2,234,093	\$ (18,419)	\$ 150,018	\$ (141,199)	\$ 2,228,202

See accompanying notes to consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (Continued)

(in thousands)

	Shares Exchangeable into				Accumulated				
	Common Stock		Common Stock		Additional Paid-in Capital	Deferred Stock Compensation	Retained	Other	Total
	Shares	Amount	Shares	Amount			Earnings (Deficit)	Comprehensive Loss	
Balance, December 31, 2004	1,303	\$ 13	369,624	\$ 3,696	\$ 2,234,093	\$ (18,419)	\$ 150,018	\$ (141,199)	\$ 2,228,202
Net income							430,412		430,412
Cumulative effect of accounting change						(2,777)			(2,777)
Other comprehensive loss								(34,513)	(34,513)
Issuance of common stock on exercise of forward contract					14,479				14,479
Exercise of stock options and purchase plans, including tax benefit			7,779	78	77,657				77,735
Employee stock purchase plan			902	9	8,377				8,386
Repurchases of common stock			(4,548)	(45)	(58,170)				(58,215)
Issuance of common stock upon acquisition			1,632	17	26,634				26,651
Issuance of common stock upon BrownCo Financing			39,722	397	691,385				691,782
Cancellation of restricted stock			(516)	(5)	(2,952)	2,957			
Issuance of restricted stock			830	8	9,892	(9,900)			
Amortization of deferred stock compensation prior to adoption of SFAS No. 123(R), net of cancellations and retirements			(46)	(1)	(709)	1,974			1,264
Reclassification of deferred stock compensation to APIC under SFAS No. 123(R)					(26,165)	26,165			
Share-based compensation expense under SFAS No. 123(R)					16,276				16,276
Conversion of Exchangeable Shares to common stock	(1,303)	(13)	1,303	13					
Other			(100)	(1)	(121)				(122)
Balance, December 31, 2005		\$	416,582	\$ 4,166	\$ 2,990,676	\$	\$ 580,430	\$ (175,712)	\$ 3,399,560

See accompanying notes to consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 430,412	\$ 380,483	\$ 203,027
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change, net of tax	(1,646)		
Provision for loan losses	54,016	38,121	38,523
Depreciation, amortization and discount accretion	362,965	398,297	443,746
Realized gain and impairment of investments	(174,798)	(257,465)	(435,146)
Loss (gain) on disposition of assets	1,342	(57,451)	
Gain on sale of Consumer Finance Corporation	(46,099)		
Minority interest and equity in income of subsidiaries and investments	(6,517)	(9,882)	(14,834)
Unrealized loss on venture funds	228	5,413	5,640
Noncash restructuring costs and other exit activities	6,528	15,029	70,811
Stock-based compensation	18,253	4,654	2,287
Deferred income taxes	49,018	66,920	7,015
Other	(8,474)	11,503	16,033
Net effect of changes in assets and liabilities:			
Decrease (increase) in cash and investments required to be segregated under Federal or other regulations	518,021	936,492	(171,287)
Increase in brokerage receivables	(953,391)	(713,656)	(856,359)
Increase (decrease) in brokerage payables	339,132	(117,567)	924,051
Proceeds from sales, repayments and maturities of loans held-for-sale	7,182,775	6,857,431	13,662,209
Purchases of loans held-for-sale	(3,717,745)	(6,063,974)	(12,951,831)
Proceeds from sales, repayments and maturities of trading securities	3,779,503	9,354,027	14,749,315
Purchases of trading securities	(6,751,698)	(9,122,071)	(15,204,220)
Other assets	28,047	(69,810)	75,329
Accrued interest receivable and payable, net	(38,315)	(13,207)	12,814
Accounts payable, accrued and other liabilities	(209,768)	(36,757)	127,666
Restructuring liabilities	(5,053)	(11,564)	(30,626)
Net cash provided by operating activities	856,736	1,594,966	674,163
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of mortgage-backed and investment securities, available-for-sale	(13,761,461)	(20,701,412)	(21,516,669)
Proceeds from sales, maturities of and principal payments on mortgage-backed and investment securities, available-for-sale	13,606,932	17,995,471	20,271,822
Net increase in loans receivable	(7,887,040)	(3,487,941)	(2,426,789)
Purchase of Federal Home Loans Bank stock	(106,695)	(12,769)	
Purchases of property and equipment	(79,014)	(108,887)	(60,121)
Proceeds from sale of property and equipment		5,957	3,846
Cash used in business acquisitions, net	(2,218,932)	(19,025)	(3,466)
Cash flow from derivative hedging assets, net	(34,696)	(33,354)	(59,607)
Proceeds from sales of discontinued businesses	56,902	106,868	
Other	19,376	1,613	(1,908)
Net cash used in investing activities	\$ (10,404,628)	\$ (6,253,479)	\$ (3,792,892)

See accompanying notes to consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(in thousands)

	Year Ended December 31,		
	2005	2004	2003
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase (decrease) in deposits	\$ 3,668,914	\$ (202,544)	\$ 4,113,280
Advances from the Federal Home Loan Bank	19,638,000	7,041,000	1,634,700
Payments on advances from the Federal Home Loan Bank	(17,267,000)	(6,472,000)	(2,025,000)
Net increase (decrease) in securities sold under agreements to repurchase	1,181,832	4,603,641	(343,324)
Net decrease in other borrowed funds	(12,151)	(64,215)	(208,479)
Proceeds from bank loans and lines of credit, net of transaction costs		23,500	
Payments on bank loans and lines of credit		(753)	(5,090)
Net proceeds from senior notes	992,064	394,000	
Payments on call of convertible subordinated notes		(428,902)	
Proceeds from issuance of common stock	691,783		
Proceeds from issuance of Units	436,500		
Proceeds from issuance of common stock from employee stock transactions	61,351	43,974	51,740
Tax benefit from tax deductions in excess of compensation expense recognition	24,530	22,441	13,186
Repayment of capital lease obligations	(157)	(734)	(6,031)
Repurchases of common stock	(58,215)	(175,776)	
Proceeds from issuance of subordinated debentures and trust preferred securities	50,000	75,630	58,210
Payments on trust preferred securities		(23,375)	
Net cash flow from derivative hedging liabilities	45,056	(159,591)	(30,916)
Other	(333)	759	14,212
Net cash provided by financing activities	9,452,174	4,677,055	3,266,488
INCREASE (DECREASE) IN CASH AND EQUIVALENTS			
CASH AND EQUIVALENTS, Beginning of year	939,906	921,364	773,605
CASH AND EQUIVALENTS, End of year	\$ 844,188	\$ 939,906	\$ 921,364
SUPPLEMENTAL DISCLOSURES:			
Cash paid for interest	\$ 723,718	\$ 437,714	\$ 430,855
Cash paid for income taxes	\$ 206,494	\$ 101,309	\$ 42,555
Non-cash investing and financing activities:			
Transfers from loans to other real estate owned and repossessed assets	\$ 50,191	\$ 47,080	\$ 48,947
Reclassification of loans held-for-sale to loans held-for-investment	\$ 178,347	\$	\$ 289,592
Deconsolidation of trust preferreds to other borrowings	\$	\$	\$ 201,665
Issuance of common stock to retire debentures	\$	\$ 79,963	\$

See accompanying notes to consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization E*TRADE Financial Corporation (together with its subsidiaries, E*TRADE or the Company) is a global company offering a wide range of financial services to the consumer under the brand E*TRADE FINANCIAL. The Company offers investing, trading, cash management and lending products and services to its retail and institutional customers.

Basis of Presentation The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. Entities in which the Company holds at least a 20% ownership or in which there are other indicators of significant influence are generally accounted for by the equity method. Entities in which the Company holds less than 20% ownership and does not have the ability to exercise significant influence are generally carried at cost. Intercompany accounts and transactions are eliminated in consolidation. The Company evaluates investments including joint ventures, low income housing tax credit partnerships and other limited partnerships to determine if the Company is required to consolidate the entities under the guidance of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities-an interpretation of ARB No. 51 (FIN 46R)*.

Certain prior period items in these consolidated financial statements have been reclassified to conform to the current period presentation. As discussed in Note 3, the operations of certain businesses 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, results of operations from prior periods have been reclassified to discontinued operations. Unless noted, discussions herein pertain to the Company s continuing operations.

Use of Estimates The consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the periods presented. Actual results could differ from management s estimates. Material estimates in which management believes near-term changes could reasonably occur include: allowances for loan losses and uncollectible margin loans; classification and valuation of certain investments; valuation and accounting for financial derivatives; estimates of effective tax rates, deferred taxes and valuation allowances; valuation of goodwill and other intangibles and valuation and expensing of share-based payments.

Financial Statement Descriptions and Related Accounting Policies Below are descriptions and accounting policies for the Company s financial statement categories.

Cash and Equivalents For the purpose of reporting cash flows, the Company considers all highly liquid investments with original or remaining maturities of three months or less at the time of purchase that are not required to be segregated under Federal or other regulations to be cash equivalents. Cash and equivalents are composed of interest-bearing and non-interest-bearing deposits, certificates of deposit, commercial paper, funds due from banks and Federal funds. Cash and equivalents included \$7.1 million and \$23.7 million at December 31, 2005 and 2004, respectively, of overnight cash deposits that the Company is required to maintain with the Federal Reserve Bank.

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Cash and Investments Required to be Segregated Under Federal or Other Regulations Cash and investments required to be segregated under Federal or other regulations consist primarily of interest-bearing cash accounts. Certain cash balances, related to collateralized financing transactions by our brokerage subsidiaries, are required to be segregated for the exclusive benefit of our brokerage customers.

Brokerage Receivables, net and Payables Brokerage receivables represent credit extended to customers to finance their purchases of securities by borrowing against securities they currently own, as well as commission

receivables from customers upon settlement of their trades. Receivable from non-customers represent credit extended to principal officers and directors of the Company to finance their purchase of securities by borrowing against securities owned by them. Brokerage receivables are recorded net of allowance for doubtful accounts. Securities owned by customers and non-customers are held as collateral for amounts due on brokerage receivables, the value of which is not reflected in the 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. Receivables from brokers, dealers and clearing organizations result from the Company's stock borrowing activities.

Brokerage payables include payables from customers, non-customers, brokers, dealers and clearing organizations. Brokerage payables to customers and non-customers represent credit balances in customer accounts arising from deposits of funds and sales of securities, also referred to as free credit balances, and other funds pending completion of securities transactions. The Company pays interest on certain free credit balances. Payables from brokers, dealers and clearing organizations also result from the Company's stock lending activities.

Deposits paid for securities borrowed and deposits received for securities loaned are recorded at the amount of cash collateral advanced or received, which are included in brokerage receivables, net and brokerage payables, respectively, on the consolidated balance sheets. Deposits paid for securities borrowed transactions require the Company to deposit cash with the counterparty. This cash is included in cash and investments required to be segregated under federal or other regulations. With respect to deposits received for securities loaned, the Company receives collateral in the form of cash in an amount generally in excess of the market value of the securities loaned. Interest income and interest expense are recorded on an accrual basis. The Company monitors the market value of the securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded, as necessary.

Trading Securities Certain trading securities and financial derivative instruments, that are not designated for hedge accounting, are bought and held principally for the purpose of selling them in the near term and are carried at estimated fair value based on quoted market prices. Realized and unrealized gains and losses on securities classified as trading held by the Bank are included in gain on sales of loans and securities, net and are derived using the specific identification cost method. Realized and unrealized gains and losses on trading securities held by broker-dealers are recorded in principal transactions and are also derived by the specific identification method.

Available-for-Sale Mortgage-Backed and Investment Securities The Company classified its debt, mortgage-backed securities and marketable equity securities as either trading or available-for-sale. None of the Company's mortgage-backed or investment securities were classified as held-to-maturity at December 31, 2005 or 2004.

Available-for-sale securities consist of mortgage-backed securities, asset-backed securities, corporate bonds, municipal bonds, publicly traded equity securities, retained interests from securitizations and other debt securities. Securities classified as available-for-sale are carried at fair value, with the unrealized gains and losses reflected as a component of accumulated other comprehensive income (AOCI), net of tax. Fair value is based on quoted market prices, when available. For illiquid securities, fair value is estimated by obtaining market price quotes on similar liquid securities and adjusting the price to reflect differences between the two securities, such as credit risk, liquidity, term, coupon, payment characteristics and other information. Realized and unrealized gains or losses on available-for-sale securities, except for publicly traded equity securities, are computed using the specific identification cost method. Amortization or accretion of premiums and discounts are recognized in interest income using the interest method over the expected life of the security. Realized and unrealized gains or losses on publicly traded equity securities are computed using the average cost method. Realized gains and losses and declines in fair value judged to be other-than-temporary are included in gain on sales of loans and securities,

net for the Company's banking operations; other amounts relating to corporate investments are included in gain on sale and impairment of investments. Interest earned is included in interest income for banking operations or corporate interest income for corporate investments.

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. 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 Emerging Issues Task Force 99-20 (EITF 99-20), *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests 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 gain on sales of loans and securities, net in the consolidated statements of income.

Asset Securitization and Retained Interests An asset securitization involves the transfer of financial assets to another entity in exchange for cash and/or beneficial interests in the assets transferred. Asset transfers in which the Company surrenders control over the financial assets are accounted for as sales to the extent that consideration, other than beneficial interests in the transferred assets, is received in the exchange in accordance with SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The carrying amount of the assets transferred is allocated between the assets sold in these transactions and the retained beneficial interests, based on their relative fair values at the date of the transfer. The Company records gains or losses for the difference between the allocated carrying amount of the assets sold and the net cash proceeds received. These gains or losses are recorded in gain on sales of loans and securities, net. Fair value is determined based on quoted market prices, if available. Generally, quoted market prices are not available for beneficial interests; therefore, the Company estimates the fair value based on the present value of the associated expected future cash flows. In determining the present value of the associated expected future cash flows, management is required to make estimates and assumptions. Key estimates and assumptions include future default rates, credit losses, discount rates, prepayment speeds and collateral repayment rates. Retained beneficial interests are accounted for in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and EITF 99-20 and are included in available-for-sale investment securities in the consolidated balance sheets.

Loans Receivable, net Loans receivable, net consists of real estate and consumer loans that management has the intent and ability to hold for the foreseeable future or until maturity. These loans are carried at amortized cost adjusted for charge-offs, net allowance for loan losses, deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Loan fees and certain direct loan origination costs are deferred and the net fee or cost is recognized in interest income using the interest method over the contractual life of the loans. Premiums and discounts on purchased loans are amortized or accreted into income using the interest method over the remaining period to contractual maturity and adjusted for anticipated prepayments. The Company classifies loans as nonperforming when full and timely collection of interest or principal becomes uncertain or when they are 90 days past due. Interest previously accrued, but not collected, is reversed against

current income when a loan is placed on nonaccrual status and is considered nonperforming. Accretion of deferred fees is discontinued for nonperforming loans. Payments received on nonperforming loans are recognized as interest income when the loan is considered collectible and applied to principal when it is doubtful that full payment will be collected. Real estate loans are generally charged off to the extent that the carrying value of the loan exceeds the estimated net realizable value of the underlying collateral at the time of repossession. HELOCs are charged-off when the loan becomes 180 days past due. Consumer loans are charged off to the extent that the carrying value of the loan exceeds the estimated net realizable value of the underlying collateral when the loan becomes 120 days past due.

Allowance for Loan Losses The allowance for loan losses is management's estimate of credit losses inherent in the Company's loan portfolio as of the balance sheet date. The estimate of the allowance is based on a variety of factors, including the composition and quality of the portfolio, delinquency levels and trends, expected losses for the next twelve months, current and historical charge-off and loss experience, current industry charge-off and loss experience, the condition of the real estate market and geographic concentrations within the loan portfolio, the interest rate climate as it affects adjustable-rate loans and general economic conditions. Determining the adequacy of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses in future periods. In general, the allowance for loan losses should be at least equal to twelve months of projected losses for all loan types. Management believes this level is representative of probable losses inherent in the loan portfolio at the balance sheet date. Loan losses are charged and recoveries are credited to the allowance for loan losses.

Loans Held-for-Sale, net Loans held-for-sale, net consists of mortgages acquired and loans originated by the Company that are intended for sale in the secondary market. These loans are carried at the lower of cost or estimated fair value, as determined on an aggregate basis, based on quoted market price for loans with similar characteristics. Net unrealized losses are recognized in a valuation allowance by charges to income. Premiums and discounts on loans held-for-sale are deferred and recognized as part of gain (loss) on sales of loans held-for-sale, net and are not accreted or amortized.

Property and Equipment, net Property and equipment are carried at cost and depreciated on a straight-line basis over their estimated useful lives, generally three to ten years. Leasehold improvements are amortized over the lesser of their estimated useful lives or lease terms. Buildings are depreciated over forty years. Land is carried at cost. Technology development costs are charged to operations as incurred. Technology development costs include costs incurred in the development and enhancement of software used in connection with services provided by the Company that do not otherwise qualify for capitalization treatment as internally developed software costs in accordance with Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*.

In accordance with SOP 98-1, the cost of internally developed software is capitalized and included in property and equipment at the point at which the conceptual formulation, design and testing of possible software project alternatives are complete and management authorizes and commits to funding the project. The Company does not capitalize pilot projects and projects where it believes that future economic benefits are less than probable. Internally developed software costs include the cost of software tools and licenses used in the development of the Company's systems, as well as payroll and consulting costs.

Investment in Federal Home Loan Bank (FHLB) Stock Investment in FHLB stock is carried at its amortized cost, which approximates fair value.

Goodwill and Other Intangibles, net Goodwill and other intangibles, net represents the excess of the purchase price over the fair value of net tangible assets acquired through the Company's business combinations. The Company tests goodwill and intangible assets with indefinite lives for impairment on at least an annual basis or when certain events occur. The Company evaluates the remaining useful lives of other intangible assets each

reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization.

Servicing Rights Servicing assets are recognized when the Company sells a loan and retains the related servicing rights. The servicing rights are initially recorded at their allocated cost basis based on the relative fair value of the loan sold and the servicing rights are retained at the date of the sale in accordance with SFAS No. 140. 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 over 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 service charges and fees in the consolidated statements of income. Servicing assets are included in other assets in the consolidated balance sheets.

Real Estate Owned and Repossessed Assets Included in other assets in the consolidated balance sheets is real estate acquired through foreclosure and repossessed consumer assets. Real estate properties acquired through foreclosures, commonly referred to as real estate owned (REO) and repossessed assets, are recorded at fair value, less estimated selling costs at acquisition.

Income Taxes The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, which prescribes the use of the asset and liability method whereby deferred tax asset or liability account balances are calculated at the balance sheet date using current tax laws and rates in effect. Valuation allowances are established, when necessary, to reduce deferred tax assets when it is *more likely than not* that a portion or all of a given deferred tax assets will not be realized. In accordance with SFAS No. 109, income tax expense includes (i) deferred tax expense, which generally represents the net change in the deferred tax asset or liability balance during the year plus any change in valuation allowances and (ii) current tax expense, which represents the amount of tax currently payable to or receivable from a taxing authority plus amounts accrued for expected tax deficiencies (including both tax and interest.) Accruals for expected tax deficiencies are recorded in accordance with SFAS No. 5, *Accounting for Contingencies*, when management determines that a tax deficiency is both probable and reasonably estimable.

Securities Sold Under Agreements to Repurchase Securities under agreements to repurchase similar securities (Repurchase Agreements) are collateralized by fixed- and variable-rate mortgage-backed securities or investment grade securities. Repurchase Agreements are treated as financings for financial statement purposes and the obligations to repurchase securities sold are reflected as borrowings in the consolidated balance sheets.

Mandatory Convertible Debt The Company accounts for its mandatory convertible debt by allocating the proceeds using the relative fair value of the stock purchase contracts and the debt securities on the date of issuance. The issue costs are deferred and allocated to the debt securities and the stock purchase contracts based on their relative fair values at issuance date. The portion of issuance costs allocated to the debt is amortized over the life of the debt using the interest method.

The value of the stock purchase contracts is included in equity based on the requirements of SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*. The Company evaluated the mandatory convertible debt under SFAS No. 150 and EITF No. 00-19. In order for the stock purchase contracts to be included in equity, the following statements must be met.

The obligation settlement amount is not based on a fixed monetary amount known at inception,

The stock purchase commitment is based on the fair value of the issuer's equity shares,

The Company could not be required to net cash settle the stock purchase contract,

The Company has sufficient authorized and unissued shares available to settle the stock purchase contract, and

There is an explicit limit on the number of shares of common stock required to be delivered under the stock purchase contract.

Based on our review of the above criterion and other relevant technical requirements, the stock purchase contracts are included in equity.

Foreign Currency Translation Assets and liabilities of consolidated subsidiaries outside of the United States are translated into U.S. dollars using the exchange rate in effect at each period end. Revenues and expenses are translated at the average exchange rate during the period. The effects of foreign currency translation adjustments arising from differences in exchange rates from period to period are deferred and included in AOCI as the functional currency of our subsidiaries is their local currency. Currency transaction gains or losses, derived on monetary assets and liabilities stated in a currency other than the functional currency, are recognized in current operations and have not been significant to the Company's operating results in any period.

Advertising and Market Development Advertising production costs are expensed when the initial advertisement is run. Costs of print advertising are expensed as the services are received.

Share-Based Payments Effective July 1, 2005, the Company early adopted SFAS No. 123(R), *Share-Based Payment* and Staff Accounting Bulletin No. 107, *Share-Based Payment*, using the modified prospective application method to account for its share-based compensation plans. Upon adoption, the Company began expensing options as compensation and benefits with a one-time pre-tax credit of \$2.8 million in cumulative effect of accounting change related to estimated forfeiture on restricted stock for its adoption in 2005 related to restricted stock awards. Results for prior periods have not been restated. Prior to July 1, 2005, the Company accounted for its employee stock option and awards under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and accordingly, did not record compensation costs for option grants to employees if the exercise price equaled the fair market value on the grant date. Additionally, for restricted stock awards, compensation was recorded on a straight-line basis over the vesting period of the awards with forfeitures recorded as they occurred.

Under this transition method, compensation cost in 2005 includes the portion of options and awards vesting in the period for (1) all share-based payments granted prior to, but not vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* and (2) all share-based payments granted subsequent to July 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R.) Compensation cost for options granted prior to July 1, 2005 is recognized on an accelerated amortization method over the vesting period of the options using an estimated forfeiture rate. Compensation cost for options granted on or after July 1, 2005 is recognized on a straight-line basis over the vesting period using an estimated forfeiture rate. Also under SFAS No. 123(R), the Company has reflected the tax benefit from tax deduction in excess of compensation recognized as a financing activity in the consolidated statements of cash flows.

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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 periods prior to July 1, 2005 (in thousands, except per share amounts):

	Year Ended December 31,		
	2005	2004	2003
Net income, as reported	\$ 430,412	\$ 380,483	\$ 203,027
Add back: Stock-based employee compensation expense, net of tax included in reported net income, net of tax	11,356	3,081	2,033
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of tax	(18,733)	(22,640)	(17,561)
Pro forma net income	\$ 423,035	\$ 360,924	\$ 187,499
Income per share:			
Basic as reported	\$ 1.16	\$ 1.04	\$ 0.57
Basic pro forma	\$ 1.14	\$ 0.98	\$ 0.52
Diluted as reported	\$ 1.12	\$ 0.99	\$ 0.55
Diluted pro forma	\$ 1.10	\$ 0.94	\$ 0.51

The underlying assumptions to these fair value calculations are discussed in Note 21.

Comprehensive Income The Company's comprehensive income is comprised of net income, foreign currency cumulative translation adjustments, unrealized gains (losses) on available-for-sale mortgage-backed and investment securities and the effective portion of the unrealized gains (losses) on financial derivatives in cash flow hedge relationships, net of reclassification adjustments and related taxes.

Earnings Per Share Basic earnings per share (EPS) is computed by dividing net income by the weighted-average common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The Units will be reflected in diluted earnings per share calculations using the treasury stock method as defined by SFAS No. 128, *Earnings per Share*. Under this method, the number of shares of common stock used in calculating diluted earnings per share (based on the settlement formula applied at the end of the reporting period) is deemed to be increased by the excess, if any, of the number of shares that would be issued upon settlement of the purchase contracts less the number of shares that could be purchased by the Company in the market at the average market price during the period using the proceeds to be received upon settlement.

Financial Derivative 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, liabilities and future cash flows. The Company must also recognize certain contracts and commitments as derivatives when the characteristics of those contracts and commitments meet the definition of a derivative promulgated by SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended.

Each derivative is recorded on the balance sheet at fair value as a freestanding asset or liability. Financial derivative instruments in hedging relationships that mitigate exposure to changes in the fair value of assets or liabilities are considered fair value hedges under SFAS No. 133. Financial derivative instruments designated in hedging relationships that mitigate the exposure to the variability in expected future cash flows or other forecasted transactions are considered cash flow hedges. The Company formally documents all relationships between hedging instruments and hedged items and the risk management objective and strategy for each hedge transaction.

Fair value hedges are accounted for by recording the fair value of the financial derivative instrument and the change in fair value of the asset or liability being hedged on the consolidated balance sheets with the net difference, or hedge ineffectiveness, reported as fair value adjustments of financial derivatives in the consolidated statements of income. Cash payments or receipts and related accruals during the reporting period on derivatives included in fair value hedge relationships are recorded as an adjustment to interest income on the hedged asset or liability. If a financial derivative in a fair value hedging relationship is no longer effective, de-designated from its hedging relationship or terminated, the Company discontinues fair value hedge accounting for the derivative and the hedged item. Changes in the fair value of these derivative instruments no longer designated in an accounting hedge relationship are recorded in gain on sales of loans and securities, net, in the consolidated statements of income. The accumulated adjustment of the carrying amount of the hedged interest-earning asset or liability is recognized in earnings as an adjustment to interest income over the expected remaining life of the asset using the effective interest method.

Cash flow hedges are accounted for by recording the fair value of the financial derivative instrument as either a freestanding asset or a freestanding liability in the consolidated balance sheets, with the effective portion of the change in fair value of the financial derivative recorded in AOCI, net of tax in the consolidated balance sheets. Amounts are then included in interest expense as a yield adjustment in the same period the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the financial derivative is reported as fair value adjustments of financial derivatives in the consolidated statements of income. If it becomes probable that a hedged forecasted transaction will not occur, amounts included in AOCI related to the specific hedging instruments are reported as gain on sales of loans and securities, net in the consolidated statements of income. Derivative gains and losses that are not held as accounting hedges are recognized as gain on sales of loans and securities, net in the consolidated statements of income as these derivatives do not qualify for hedge accounting under SFAS No. 133. If a financial derivative ceases to be highly effective as a hedge, hedge accounting is discontinued prospectively and the financial derivative instrument continues to be recorded at fair value with changes in fair value being reported as gain on sales of loans and securities, net in the consolidated statements of income.

Revenue Recognition

Commissions The Company derives commissions revenue from its retail and institutional customers. Commissions revenue from securities transactions are recognized on a trade date basis. The Company receives commissions for providing certain institutional customers with market research and other information, which is a common industry practice. These commissions revenue contributed less than 10% of the Company's net revenues for all periods presented. Direct costs from these arrangements are expensed as the commissions are received, in proportion to the cost of the total arrangement. As a result, payments for independent research are deferred or accrued to properly match expenses at the time commission revenue is earned. For these arrangements, payments for independent research of \$6.0 million were deferred and costs of \$19.4 million were accrued at December 31, 2005 and payments of \$6.3 million were deferred and costs of \$18.6 million were accrued at December 31, 2004.

Principal Transactions Principal transactions consist primarily of revenue from market-making activities. Market-making activities are the matching of buyers and sellers of securities and include transactions where the Company will purchase securities for its balance sheet with the intention of resale to transact the customer's buy or sell order.

Gain on Sales of Loans and Securities, net Gain on sales of originated loans are recognized at the date of settlement and are based on the difference between the cash received and the carrying value of the related loans sold, less related transaction costs. In cases where the Company retains the servicing rights associated with loans sold, the gain recognized is the difference between cash received and the allocated basis of the loans sold, less the related transaction costs. In accordance with SFAS No. 140, the allocated basis of the loans, which is determined at the sale date, is the result of the allocation of basis between the loans sold and the associated servicing right, based on the relative fair values of the loans at the date of transfer.

Gain on sales of loans and securities, net includes gains or losses resulting from sales of loans purchased for resale; the sale or impairment of available-for-sale mortgage-backed and investment securities; and gains or losses on financial derivatives that are not accounted for as hedging instruments under SFAS No. 133. Gains or losses resulting from the sale of loans are recognized at the date of settlement and are based on the difference between the cash received and the carrying value of the related loans, less related transaction costs. Nonrefundable fees and direct costs associated with the origination of mortgage loans are deferred and recognized when the related loans are sold. Gains or losses resulting from the sale of available-for-sale securities are recognized at the trade date, based on the difference between the anticipated proceeds and the amortized cost of the specific securities sold.

Service Charges and Fees Service charges and fees consist of account maintenance fees, servicing fee income and other customer service fees. Account maintenance fees are charged to the customer either quarterly or annually and accrued as earned.

Other Revenues Other revenues consists of stock plan administration services, payments for order flow from third party market makers and foreign exchange margin revenue. Stock plan administration services are recognized in accordance with applicable accounting guidance, including SOP 97-2, *Software Revenue Recognition*. Payments for order flow revenues are accrued in the same period in which the related securities transactions are completed or related services are rendered.

Interest Income Interest income is recognized as earned on interest-earning assets, customer margin loan balances, stock borrow balances, cash required to be segregated under regulatory guidelines and fees on customer assets invested in money market funds. Interest income includes the effect of hedges on interest-earning assets.

Interest Expense Interest expense is recognized as incurred on interest-bearing liabilities, customer credit balances, interest paid to banks and interest paid to other broker-dealers through a subsidiary's stock loan program. Interest expense includes the effect of hedges on interest-bearing liabilities.

New Accounting Standards Below are the new accounting pronouncements that relate to activities the Company is engaged.

FSP 123(R)-4 Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event

On February 3, 2006, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. 123(R)-4, *Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event*. FSP 123(R)-4 addresses the classification of options and similar instruments issued as employee compensation that allow for cash settlement upon the occurrence of a contingent event. An entity must recognize a share-based liability equal to the portion of the award attributed to past service, multiplied by the award's fair value on that date for an option or similar instrument that is classified as equity, but subsequently becomes a liability because the contingent cash settlement event is probable of occurring. FSP 123(R)-4 is effective for the Company in the first quarter of 2006, with early adoption permitted. Upon adoption, the Company must retroactively restate prior periods for the change. The Company has not issued any options or similar instruments as employee compensation that allow for cash settlement upon the occurrence of a contingent event that would require a change under the FSP. Therefore, the Company does not believe this FSP will have an impact on its results of operations or financial condition.

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

In March 2004, the 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 FASB's staff issued a number of FSPs

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. In November 2005, the FASB issued FSP 115-1/124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, which nullified and replaced the qualitative and quantitative guidance for determining whether securities are other-than-temporarily impaired. The new guidance is consistent with the Company's current practice which is primarily found within SFAS No. 115 and EITF 99-20, as to the measurement and recognition of other-than-temporary impairments of its debt and equity securities.

SFAS No. 154 Accounting Changes and Error Corrections

In June 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. This statement supersedes APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. The statement applies to all voluntary changes in accounting principle and changes the requirements for accounting and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. The statement requires that a change in method of depreciation, amortization, or depletion for long-lived, nonfinancial assets be accounted for as a change in accounting estimate that is effected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of this statement. The Company will adopt SFAS No. 154, as applicable, beginning in 2006.

SOP No. 03-3 Accounting for Certain Loans or Debt Securities Acquired in a Transfer

In December 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued SOP No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* to address accounting for differences between the contractual cash flows of certain loans and debt securities and the cash flows expected to be collected when loans or debt securities are acquired in a transfer and those cash flow differences are attributable, at least in part, to credit quality. As such, SOP No. 03-3 applies to loans and debt securities purchased or acquired in purchase business combinations and does not apply to originated loans. SOP No. 03-3 requires that the excess of contractual cash flows over cash flows expected to be collected (nonaccretable difference) not be recognized as an adjustment of yield or valuation allowance, such as the allowance for credit losses. Subsequent to the initial investment, increases in expected cash flows generally should be recognized prospectively through adjustment of the yield on the loan or debt security over its remaining life. Decreases in expected cash flows should be recognized as impairment. SOP No. 03-3 is effective for loans and debt securities acquired in fiscal years beginning after December 15, 2004, with early application encouraged. In 2005, the Company adopted this new pronouncement, which effect was not material to the Company's financial condition, result of operations or cash flows.

NOTE 2 BUSINESS COMBINATIONS

Over the past two years, the Company completed several business combinations and asset acquisitions which were all accounted for under the purchase method of accounting. The purchase prices have been allocated to the net assets acquired and the liabilities assumed based on their estimated fair values at the date of acquisition. For certain acquisitions, the consolidated financial statements reflect preliminary allocations of purchase price, as appraisals of the net assets acquired have not been finalized. The Company does not expect changes in the preliminary allocations from the finalization of these appraisals to be material to its consolidated statements of income. The results of operations of each are included in the Company's consolidated statements of income from the date of each acquisition.

BrownCo

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On November 30, 2005, the Company completed its acquisition of J.P. Morgan Invest, LLC (BrownCo), an online discount brokerage business with approximately 186,000 customer accounts, from JP Morgan Chase &

Co. for an aggregate purchase price of approximately \$1.6 billion in cash. The purchase price included approximately \$306.6 million in net assets acquired, \$269.7 million in customer list and noncompete intangibles, \$9.0 million in contracts and employee termination liabilities, with the remaining \$1,062.4 million recorded as goodwill. Regulatory capital of \$294.5 million was included in the purchase price. The intangible assets will be amortized over approximately 22 years on an accelerated basis.

Harrisdirect

On October 6, 2005, the Company completed its acquisition of *Harrisdirect* LLC (*Harrisdirect*), a U.S.-based online discount brokerage business with approximately 425,000 customer accounts, from BMO Financial Group for an aggregate purchase price of approximately \$709.0 million in cash. The purchase price included approximately \$22.4 million in net assets acquired, \$156.4 million in customer list and noncompete intangibles, \$11.1 million in contract and employee termination liabilities, with the remaining \$541.4 million recorded as goodwill. Regulatory capital of \$16.0 million was included in the purchase price. The intangible assets will be amortized over approximately 19 years on an accelerated basis.

Wealth Management Advisors

The Company acquired Kobren Insight Management on November 2, 2005 and Howard Capital Management, Inc. on January 1, 2005. Both companies are registered investment advisory firms. The companies combined have over \$1.5 billion in assets under management. The Company recorded \$24.6 million of intangible assets and \$7.6 million of goodwill related to the acquisitions. The intangible assets will be amortized over approximately 20 years on an accelerated basis. In accordance with the terms of the acquisitions, the Company may pay additional cash and stock if certain milestones are met. These milestones are for certain revenues and earnings targets, which if met, will cause the Company to pay up to an additional \$34.6 million.

Active Accounts

In October 2004, the Company acquired certain active accounts from a brokerage company. The Company paid \$17.0 million in cash and recorded an intangible asset of \$17.0 million which will be amortized over 10 years.

NOTE 3 DISCONTINUED OPERATIONS

In 2005, the Company sold its Consumer Finance Corporation, exited the institutional proprietary trading business conducted by E*TRADE Professional Securities, LLC and announced its intention to sell its professional agency business which conducts its activities as E*TRADE Professional Trading, LLC. In 2004, the Company's retail segment completed the sale of substantially all of the assets and liabilities of E*TRADE Access, the company that previously owned its ATM network. All of these transactions and intended transactions, except the Consumer Finance Corporation's servicing operations, were accounted for as discontinued operations as of December 31, 2005, 2004 and 2003.

Below is a table summarizing the gains (losses), net of taxes, resulting from the sale and closure of discontinued operations (in thousands):

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	<u>Year ended December 31,</u>	
	<u>2005</u>	<u>2004</u>
Consumer Finance Corporation origination business ⁽¹⁾	\$ 6,444	\$
E*TRADE Professional	(2,421)	
E*TRADE Access		31,408
	<u> </u>	<u> </u>
Total net gain from sale of discontinued operations	\$ 4,023	\$ 31,408
	<u> </u>	<u> </u>

(1) The gain on the servicing business, which was not accounted for as a discontinued operation, is recorded in facility restructuring and other exit activities.

Consumer Finance Corporation

On October 31, 2005, the Company completed the sale of the origination and servicing business of Consumer Finance Corporation to GE Capital. The servicing business exited did not qualify as a discontinued operation; however, the origination business is accounted for as a discontinued operation. The sale resulted in a pre-tax gain of \$46.1 million upon close, \$35.5 million relating to the servicing business and \$10.6 million (\$6.4 million, net of tax), relating to the origination business.

The Company will not have significant continuing involvement in the operations of the servicing business but will continue to have significant cost-generating activities in the form of a servicing agreement. As such, the servicing business did not qualify as a discontinued operation. The Company will not have significant continuing involvement in the operations of the origination business and will not continue any significant revenue-producing or cost-generating activities of the origination business. Therefore, the results of operations, net of income taxes, of this origination business are presented as discontinued operations on the Company's consolidated statements of income for all periods presented.

The following table summarizes the results of discontinued operations for the origination business (in thousands):

	Year ended December 31,		
	2005	2004	2003
Net revenues	\$ (7,750)	\$ (5,898)	\$ 47,318
Income (loss) from discontinued operations before income taxes	\$ (22,959)	\$ (36,630)	\$ 18,912
Income tax expense (benefit)	(8,783)	(15,082)	7,432
Net income (loss) from discontinued operations	\$ (14,176)	\$ (21,548)	\$ 11,480

E*TRADE Professional

On May 9, 2005, the Company closed E*TRADE Professional Securities, LLC (ETPS), a unit that conducted proprietary trading operations. In June 2005, the Company filed to withdraw its broker-dealer license for ETPS, with an effective date of May 31, 2005. ETPS was a Philadelphia Stock Exchange (PHLX) member and a standalone entity which employed less than 200 traders. This closure resulted in a \$2.4 million, net of tax, loss on disposal of discontinued operations, which included employee terminations, facility closure and impairment of goodwill and intangibles.

In December 2005, the Company decided to sell its professional agency business, E*TRADE Professional Trading, LLC (ETPT). This business includes a broker-dealer registered with the SEC and a member of the NASD Inc. (NASD) who currently executes and clears its customer security transactions through an affiliate, E*TRADE Clearing LLC, on a fully disclosed basis under an introducing broker-dealer relationship. The Company executed a sale agreement on February 17, 2006. Under the terms of the sale agreement, the Company continues to retain the obligation for contingent liabilities that existed prior to the sale, which contingent liabilities would not, in the Company's estimation individually or collectively, be material to the Company's financial results.

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The Company will not have significant continuing involvement in the operations of either its proprietary trading or its professional agency businesses and will not continue any significant revenue-producing or cost-generating activities of these businesses. Therefore, the Company's results of operations, net of income taxes, include these businesses as discontinued operations on the Company's consolidated statements of income for all periods presented.

The following table summarizes the results of discontinued operations for the proprietary and agency trading businesses (in thousands):

	Year ended December 31,		
	2005	2004	2003
Net revenues	\$ 21,408	\$ 50,962	\$ 48,765
Loss from discontinued operations before income taxes	\$ (11,103)	\$ (13,851)	\$ (12,919)
Income tax benefit	(3,784)	(4,499)	(5,610)
Net loss from discontinued operations	\$ (7,319)	\$ (9,352)	\$ (7,309)

E*TRADE Access

In 2004, the Company completed the sale of substantially all of the assets and liabilities of E*TRADE Access to Cardtronics, LP and Cardtronics, Inc. Although the Company believes that an 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. The Company has reflected E*TRADE Access results of operations, financial position and cash flows as discontinued operations in the consolidated financial statements for all periods reported herein.

The following table summarizes the results of discontinued operations of our ATM business for the periods presented (in thousands):

	Year Ended December 31,	
	2004	2003
Revenues	\$ 20,029	\$ 44,909
Loss from discontinued operations before income taxes	\$ (3,085)	\$ (2,700)
Income tax benefit	(1,230)	(1,035)
Loss from discontinued operations	\$ (1,855)	\$ (1,665)

NOTE 4 FACILITY RESTRUCTURING AND OTHER EXIT ACTIVITIES

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

	Year Ended December 31,		
	2005	2004	2003
Exit of Consumer Finance Corporation servicing business	\$ (35,496)	\$	\$
Israel exit activities		14,500	1,435
2003 Restructuring Plan	2,002	1,857	112,564
2001 Restructuring Plan	1,096	(800)	16,367
Other exit activities	2,381	131	3,821
Total restructuring and other exit activities	\$ (30,017)	\$ 15,688	\$ 134,187

Exit of Consumer Finance Business

On October 31, 2005, the Company completed the sale of the servicing and origination businesses of Consumer Finance Corporation to GE Capital resulting in a pre-tax gain of \$46.1 million. The pre-tax gain from the servicing business of \$35.5 million is reflected in other exit activity as the servicing business was not deemed to be a discontinued operation. (See Note 3 for additional information.)

Israel Exit Activity

The Company terminated the trademark and technology license of an Israeli-based company in 2002 due to failure to perform obligations and commenced arbitration proceedings. The Israeli company counterclaimed for wrongful termination. An arbitration tribunal in London decided against the Company and as a result, the Company recognized \$14.5 million and \$1.4 million in exit activities for 2004 and 2003.

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 served as an introduction point for new customers to the Company's products and services. The Company exited this 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 new 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 moved 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 to focus on other methods of reaching its current and potential customers.

In 2004, the Company completed its exit of the Enlight Holdings, LLC product offering resulting in adjustments to estimated costs associated with its exit. In 2005, the Company made additional adjustment to previously estimated costs associated with the consolidation of facilities in California. The rollforward of the 2003 Restructuring Plan reserve is presented below (in thousands):

	Facility		Total
	Consolidation	Other	
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	2,458	(601)	1,857
Cash payments	(5,439)	(2,249)	(7,688)
Restructuring liabilities at December 31, 2004	21,768	371	22,139
2005 activity on original 2003 restructuring reserve:			
Adjustment and additional charges recorded in 2005	2,042	(40)	2,002
Cash payments	(5,093)	(331)	(5,424)
Restructuring liabilities at December 31, 2005	\$ 18,717	\$	\$ 18,717

2001 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, bring together key decision-makers and streamline operations. The original 2001 restructuring charge related to facility consolidation represents 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	Asset	Other	Total
	Consolidation	Write-Off		
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	(800)			(800)

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Cash payments	(5,489)		(6)	(5,495)
Restructuring liabilities at December 31, 2004	10,240	660	166	11,066
2005 activity on original 2001 restructuring reserve:				
Adjustments and additional charges recorded in 2005	543	(220)	773	1,096
Cash payments	(3,328)	(440)	(147)	(3,915)
Restructuring liabilities at December 31, 2005	\$ 7,455	\$	\$ 792	\$ 8,247

Facility Consolidation Obligations

The components of the facility consolidation restructuring liabilities for the 2003 and 2001 Restructuring Plans at December 31, 2005, and their timing are as follows (in thousands):

Year	Facilities Obligations	Sublease Income		Discounted	Net
		Contracted	Estimate	Rents and Sublease	
2006	\$ 12,542	\$ (2,952)	\$ (224)	\$ (1,000)	\$ 8,366
2007	10,537	(2,360)	(966)	(735)	6,476
2008	7,886	(1,839)	(835)	(352)	4,860
2009	6,382	(1,440)	(716)	(151)	4,075
2010	3,535	(731)	(488)	(61)	2,255
Thereafter	922	(782)			140
Total	\$ 41,804	\$ (10,104)	\$ (3,229)	\$ (2,299)	\$ 26,172

Other Exit Activities

Other exit activities in 2005 are primarily related to the liquidation of proprietary money market funds and the outsourcing of certain brokerage activities. These costs primarily relate to customer notification, reimbursement of losses taken on sale of securities and severance. Other exit charges in 2003 were primarily related to the gain on sale of the Company's German subsidiary, partially offset by the charges relating to the exit of the Company's proprietary institutional research business located in Europe.

NOTE 5 BROKERAGE RECEIVABLES, NET AND BROKERAGE PAYABLES

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

	December 31,	
	2005	2004
Receivable from customers and non-customers (less allowance for doubtful accounts of \$8,835 at December 31, 2005 and \$1,970 at December 31, 2004)	\$ 5,678,923	\$ 2,214,210
Receivable from brokers, dealers and clearing organizations:		
Deposits paid for securities borrowed	1,163,125	613,546
Net settlement and deposits with clearing organizations	230,936	158,780
Other	101,191	48,012
Total brokerage receivables, net	\$ 7,174,175	\$ 3,034,548

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Payable to customers and non-customers	\$ 5,817,469	\$ 2,805,662
Payable to brokers, dealers and clearing organizations:		
Deposits received for securities loaned	1,320,853	735,622
Other	177,337	77,608
Total brokerage payables	\$ 7,315,659	\$ 3,618,892

Receivables from customers and non-customers are brokerage receivables whereby credit is extended to customers to finance their purchases of securities by borrowing against securities they currently own (also known as margin balances). At December 31, 2005, the fair value of securities that the Company received as collateral, where the Company is permitted to sell or repledge the securities, is approximately \$8.8 billion. Of this amount, \$2.4 billion has been pledged or sold at December 31, 2005 in connection with securities lending, bank borrowings and deposits with clearing organizations.

NOTE 6 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):

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Values</u>
December 31, 2005:				
Mortgage-backed securities:				
U.S. Government sponsored enterprise obligations:				
Federal National Mortgage Association	\$ 7,468,607	\$	\$ (199,259)	\$ 7,269,348
Government National Mortgage Association	2,198,009		(59,739)	2,138,270
Federal Home Loan Mortgage Corporation	21,050		(1,147)	19,903
	<u>9,687,666</u>		<u>(260,145)</u>	<u>9,427,521</u>
Total U.S. government sponsored enterprise Collateralized mortgage obligations and other	1,014,582	315	(19,006)	995,891
	<u>10,702,248</u>	<u>315</u>	<u>(279,151)</u>	<u>10,423,412</u>
Investment securities:				
Debt securities:				
Asset-backed securities	1,376,315	1,811	(12,372)	1,365,754
Municipal bonds	168,682	1,884	(882)	169,684
Corporate bonds	74,931		(2,171)	72,760
Other debt securities	78,989		(5,504)	73,485
	<u>1,698,917</u>	<u>3,695</u>	<u>(20,929)</u>	<u>1,681,683</u>
Total debt securities	1,698,917	3,695	(20,929)	1,681,683
Publicly traded equity securities	343,392	94,679	(2,306)	435,765
Retained interests from securitizations	22,444	1,434		23,878
	<u>2,064,753</u>	<u>99,808</u>	<u>(23,235)</u>	<u>2,141,326</u>
Total investment securities	2,064,753	99,808	(23,235)	2,141,326
Total available-for-sale securities	<u>\$ 12,767,001</u>	<u>\$ 100,123</u>	<u>\$ (302,386)</u>	<u>\$ 12,564,738</u>
December 31, 2004:				
Mortgage-backed securities:				
U.S. Government sponsored enterprise obligations:				
Federal National Mortgage Association	\$ 5,149,991	\$ 203	\$ (87,990)	\$ 5,062,204
Government National Mortgage Association	2,767,087	349	(56,628)	2,710,808
Federal Home Loan Mortgage Corporation	21,057		(862)	20,195
	<u>7,938,135</u>	<u>552</u>	<u>(145,480)</u>	<u>7,793,207</u>
Total U.S. government sponsored enterprise Collateralized mortgage obligations and other	1,266,736	5,008	(12,882)	1,258,862
	<u>9,204,871</u>	<u>5,560</u>	<u>(158,362)</u>	<u>9,052,069</u>
Total mortgage-backed securities	9,204,871	5,560	(158,362)	9,052,069
Investment securities:				
Debt securities:				
Asset-backed securities	2,789,471	21,662	(14,704)	2,796,429
Municipal bonds	136,362	1,391	(1,082)	136,671

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Corporate bonds	87,959		(3,444)	84,515
Other debt securities	80,189		(4,767)	75,422
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total debt securities	3,093,981	23,053	(23,997)	3,093,037
Publicly traded equity securities	295,593	81,304	(2,055)	374,842
Retained interests from securitizations	23,870			23,870
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total investment securities	3,413,444	104,357	(26,052)	3,491,749
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total available-for-sale securities	\$ 12,618,315	\$ 109,917	\$ (184,414)	\$ 12,543,818
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Other-Than-Temporary Impairment of Investments

The following tables show 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 (in thousands):

	Less than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	Losses
December 31, 2005:						
Mortgage-backed securities:						
Backed by Federal agencies	\$ 5,914,808	\$ (142,245)	\$ 3,512,713	\$ (117,900)	\$ 9,427,521	\$ (260,145)
Other	351,565	(5,177)	546,291	(13,829)	897,856	(19,006)
Asset-backed securities	412,142	(3,064)	411,595	(9,308)	823,737	(12,372)
Municipal bonds	21,006	(165)	22,775	(717)	43,781	(882)
Corporate bonds			72,760	(2,171)	72,760	(2,171)
Other debt securities			73,485	(5,504)	73,485	(5,504)
Publicly traded equity securities	86,538	(1,335)	11,759	(971)	98,297	(2,306)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total temporarily impaired securities	\$ 6,786,059	\$ (151,986)	\$ 4,651,378	\$ (150,400)	\$ 11,437,437	\$ (302,386)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
December 31, 2004:						
Mortgage-backed securities:						
Backed by Federal agencies	\$ 5,504,676	\$ (85,020)	\$ 2,135,727	\$ (60,460)	\$ 7,640,403	\$ (145,480)
Other	704,369	(6,715)	175,678	(6,167)	880,047	(12,882)
Asset-backed securities	771,250	(5,851)	20,769	(8,853)	792,019	(14,704)
Municipal bonds	72,146	(1,082)			72,146	(1,082)
Corporate bonds			84,515	(3,444)	84,515	(3,444)
Other debt securities			74,700	(4,767)	74,700	(4,767)
Publicly traded equity securities	52,717	(2,055)			52,717	(2,055)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total temporarily impaired securities	\$ 7,105,158	\$ (100,723)	\$ 2,491,389	\$ (83,691)	\$ 9,596,547	\$ (184,414)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The Company does not believe any individual loss as of December 31, 2005 represents an other-than-temporary impairment. The majority of the unrealized losses on mortgage- and asset-backed securities are attributable to changes in interest rates and not reflective of deterioration in the credit quality of the issuer and/or securitization. Substantially all mortgage-backed securities backed by Federal agencies are AAA rated and have unrealized losses due to changes in market interest rates. As market interest rates increase, the fair value of fixed-rate securities will decrease. During 2005, increasing market interest rates caused higher unrealized losses on our fixed-rate securities including mortgage- and asset-backed securities. The Company has the ability and intent to hold these securities until the market value recovers or the securities mature. Asset-backed securities, corporate bonds and other debt securities are evaluated by reviewing the credit worthiness of the lender and based on market conditions. As of December 31, 2005, unrealized losses on mortgage- and asset-backed securities were primarily attributed to rising interest rates and not underlying credit impairment. Based on its evaluation, the Company recorded other-than-temporary charges of \$38.3 million, \$14.0 million and \$2.2 million for 2005, 2004 and 2003, respectively, for its asset- and mortgage-backed securities and interest-only securities. Additionally, the Company recognized \$2.0 million and \$4.4 million of other-than-temporary impairments for 2005 and 2004, respectively, from retained beneficial interests in securitized receivables held by a subsidiary, ETCF Asset Funding Corporation.

Publicly Traded Equity Securities

For the years ended December 31, 2005, 2004 and 2003, the Company recognized gains on sales of its publicly traded equity securities of \$82.7 million, \$130.6 million and \$151.7 million, respectively. In 2005, these gains included sales of the Company's holdings in Softbank Investment Corporation (SBI), all of its holdings in Archipelago Holdings Incorporated, Ameritrade Holding Corporation and holdings in International Stock Exchange of \$59.7 million, \$9.8 million, \$8.4 million and \$4.8 million, respectively. In 2004 and 2003, these gains primarily included sales of the Company's holdings in SBI.

Contractual Maturities

The contractual maturities of available-for-sale debt securities, including mortgage-backed securities, at December 31, 2005 are shown below (in thousands):

	Amortized Cost	Estimated Fair Values
	<u> </u>	<u> </u>
Due within one year	\$ 3	\$ 3
Due within one to five years	31,371	31,369
Due within five to ten years	99,019	93,298
Due after ten years	12,270,772	11,980,425
	<u> </u>	<u> </u>
Total available-for-sale debt securities	<u>\$ 12,401,165</u>	<u>\$ 12,105,095</u>

The Company pledged \$11.8 billion at December 31, 2005 and \$10.1 billion at December 31, 2004 of mortgage-backed securities as collateral for repurchase agreements, short-term borrowings, derivative instruments and FHLB advances.

Realized Gains (Losses)

Realized gains and losses from the sales and other-than-temporary impairment of available-for-sale investment securities, including mortgage-backed securities, are as follows (in thousands):

	Year Ended December 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Mortgage-backed securities:			
Realized gains	\$ 130,840	\$ 105,876	\$ 138,781
Realized losses	(100,765)	(47,785)	(47,046)
Impairment charges	(30,924)	(12,400)	

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Net realized gains (losses) on mortgage-backed securities included in gain on sales of loans and securities, net	\$ (849)	\$ 45,691	\$ 91,735
Other investments:			
Realized gains	\$ 126,104	\$ 152,480	\$ 194,511
Realized losses	(8,878)	(6,596)	(21,980)
Impairment charges	(7,419)	(1,558)	(2,198)
Net realized gains included in gain on sales of loans and securities, net and gain on sale and impairment of investments	\$ 109,807	\$ 144,326	\$ 170,333

During 2005, 2004 and 2003, the Company realized gains from the sales of trading securities of \$108.8 million, \$101.3 million and \$81.3 million, respectively. In addition, the Company had unrealized trading asset appreciation of \$0.6 million, \$2.5 million and \$4.8 million in 2005, 2004 and 2003, respectively.

NOTE 7 LOANS, NET

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

	<u>Held-for- Investment</u>	<u>Held-for- Sale</u>	<u>Total Loans</u>
<u>December 31, 2005:</u>			
Real estate loans:			
One- to four-family	\$ 7,091,664	\$ 87,233	\$ 7,178,897
HELOC, second mortgage and other	8,106,820	74	8,106,894
Total real estate loans	15,198,484	87,307	15,285,791
Consumer and other loans:			
RV	2,692,055		2,692,055
Marine	752,645		752,645
Automobile	235,388		235,388
Credit card	188,600		188,600
Other	97,436		97,436
Total consumer and other loans	3,966,124		3,966,124
Total loans	19,164,608	87,307	19,251,915
Unamortized premiums, net	323,573	64	323,637
Allowance for loan losses	(63,286)		(63,286)
Total loans, net	\$ 19,424,895	\$ 87,371	\$ 19,512,266
<u>December 31, 2004:</u>			
Real estate loans:			
One- to four-family	\$ 3,669,594	\$ 244,593	\$ 3,914,187
HELOC, second mortgage and other	3,618,740	3,095	3,621,835
Total real estate loans	7,288,334	247,688	7,536,022
Consumer and other loans:			
RV	2,542,645	25,246	2,567,891
Marine	720,513	3,612	724,125
Automobile	583,354	35	583,389
Credit card	203,169		203,169
Other	19,493		19,493
Total consumer and other loans	4,069,174	28,893	4,098,067
Total loans	11,357,508	276,581	11,634,089
Unamortized premiums, net	195,928	2,699	198,627
Allowance for loan losses	(47,681)		(47,681)
Total loans, net	\$ 11,505,755	\$ 279,280	\$ 11,785,035

In addition to these loans, net, the Company had commitments to originate, buy and sell loans at December 31, 2005 (see Note 24.)

Approximately 32% and 45% of the Company's real estate loans were concentrated in California at December 31, 2005 and 2004, respectively. No other state had concentrations of real estate loans that represented 10% or more of the Company's real estate portfolio.

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The following table shows the percentage of adjustable and fixed-rate loans in the Company's portfolio (dollars in thousands):

	December 31, 2005		December 31, 2004	
	\$ Amount	% of Total	\$ Amount	% of Total
Adjustable rate loans:				
Real estate	\$ 10,972,028	57.0%	\$ 6,839,796	58.8%
Credit card and other	277,597	1.4	206,039	1.8
Total adjustable rate loans	11,249,625	58.4	7,045,835	60.6
Fixed rate loans	8,002,290	41.6	4,588,254	39.4
Total loans	\$ 19,251,915	100.0%	\$ 11,634,089	100.0%

The weighted-average remaining maturity of mortgage loans secured by one- to four-family residences was 341 and 340 months at December 31, 2005 and 2004, respectively. Additionally, all mortgage loans outstanding at December 31, 2005 and 2004 in the held-for-investment portfolio were serviced by other companies.

The Company actively sells its originated loans and loans originated by correspondents. The Company may sell loans that it originally purchased from others. A summary of these activities is presented below (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Loans sold:			
Originated	\$ 2,728,094	\$ 4,339,901	\$ 9,401,248
Purchased	1,028,747	2,395,886	4,114,563
Total loans sold	\$ 3,756,841	\$ 6,735,787	\$ 13,515,811
Gain on sales of loans:			
Originated	\$ 54,847	\$ 82,716	\$ 150,393
Purchased	(1,208)	(3,447)	186
Total gain on sale of loans	\$ 53,639	\$ 79,269	\$ 150,579

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

Year Ended December 31,

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	<u>2005</u>	<u>2004</u>	<u>2003</u>
Allowance for loan losses, beginning of year	\$ 47,681	\$ 37,847	\$ 27,666
Provision for loan losses	54,016	38,121	38,523
Acquired through acquisitions		1,547	2,748
Charge-offs	(56,847)	(50,341)	(53,734)
Recoveries	18,436	20,507	22,644
	<u> </u>	<u> </u>	<u> </u>
Allowance for loan losses, end of year	<u>\$ 63,286</u>	<u>\$ 47,681</u>	<u>\$ 37,847</u>

During 2005, the allowance for loan losses increased by \$15.6 million. Approximately \$12.9 million of this increase is due to higher real estate loans outstanding which increased by \$8.1 billion during 2005. The remaining increase in the allowance was due to slightly higher expected losses on RV and credit card loans offset by lower automobile loan related losses.

The \$8.6 million increase in net charge-offs in 2005 was primarily due to higher net charge-offs on credit cards of \$6.7 million, marine and RV of \$4.7 million and real estate loan portfolios of \$2.8 million, offset partially by lower net charge-offs on automobile loans of \$5.8 million. Higher credit card charge-offs are the

result of increased bankruptcy filings as customers declared bankruptcy ahead of the new bankruptcy laws in October 2005. We do not anticipate that the 2005 level of credit card charge-offs will continue. The increase in net charge-offs was also due to growth in loans receivable and specific events affecting customer behavior during the period and not indicative of a decline in credit quality.

We classify loans as nonperforming when full and timely collection of interest or principal becomes uncertain or when they are 90 days past due. The following is the relative breakout of nonperforming loans (in thousands):

	December 31,	
	2005	2004
First mortgage loans, secured by one- to four-family residences	\$ 18,067	\$ 11,029
HELOC and second mortgage	9,568	2,755
Credit card	2,858	2,999
RV	2,826	1,416
Other	1,335	1,756
Total nonperforming loans	\$ 34,654	\$ 19,955

If the Company's nonperforming loans at December 31, 2005, had been performing in accordance with their terms, the Company would have recorded additional interest income of approximately \$0.8 million, \$1.0 million and \$1.1 million in 2005, 2004 and 2003, respectively. During 2005, we recognized \$1.0 million in interest on loans that were in nonperforming status at December 31, 2005. At December 31, 2005 and 2004, there were no commitments to lend additional funds to any of these borrowers.

NOTE 8 ASSET SECURITIZATION

Collateralized Debt Obligations

On December 1, 2005, the Company and an unrelated financial advisor transferred asset-backed securities to E*TRADE ABS CDO IV, Ltd. (CDO IV). The Company utilized a warehouse line to purchase the asset-backed securities that were sold to CDO IV. As of December 31, 2005, 92% of the pool of underlying securities had been transferred into CDO IV. Additional purchases of asset-backed securities were made in open market transactions and transferred to CDO IV in January and February 2006. In prior years, the Company transferred asset-backed securities to E*TRADE ABS CDO III, Ltd. (CDO III), E*TRADE ABS CDO II, Ltd. (CDO II) and E*TRADE ABS CDO I, Ltd. (CDO I). Asset-backed securities were also transferred to CDO III by an unrelated financial advisor. Concurrent with these transfers, the respective CDOs sold beneficial interests to independent investors in the form of senior and subordinated notes and preference shares, collateralized by the asset-backed securities. Neither the CDOs themselves nor the investors in the beneficial interests sold by the CDOs have recourse to the Company. CDO I, II and III are qualifying special purpose entities as defined in SFAS No. 140, and, as such, are not required to be consolidated in the Company's consolidated financial statements.

CDO IV is not a qualified special purpose entity but rather a special purpose entity, as the Company has been appointed by the CDO to actively manage the collateral of the CDO. The transaction was accounted for as a sale in accordance with SFAS No. 140. The CDO IV transaction differs from the previous three CDO transactions in that it is a managed deal whereby the portfolio manager (E*TRADE Global Asset Management (ETGAM)) is appointed to actively manage the collateral of the CDO as opposed to a static deal where the collateral is fixed

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throughout the life of the CDO. Because CDO IV is a managed deal, it is a special purpose entity and not a qualified special purpose entity.

The Company reviewed CDO IV to determine if consolidation was necessary under the requirements of FIN 46R. The calculation of the CDO s beneficial interests indicated that ETGAM was not the recipient of the

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majority of the potential benefits or losses of the deal and therefore, not the primary beneficiary of the transaction and not required to consolidate the CDO.

The Company purchased preference shares in each of the CDOs. Retained interests are subordinate to the notes sold by each CDO and on an equal standing with the preference shares purchased by other preference share investors in each CDO. The Company also purchased \$1 million of the BBB subordinated notes in the CDO IV transaction.

The following table summarizes the asset-backed securities transferred to each CDO, the amount of the cash proceeds, the preference shares purchased by the Company and the current rating for those preference shares (dollars in millions):

CDO	Transaction Date	Asset-Backed Securities Transferred to CDO				Preference Shares Purchased by E*TRADE			
		E*TRADE	Independent Investment Advisor	Total	Proceeds	Amount	Rating at 12/31/05		
							Moody's	S&P	
CDO IV	December 2005	\$ 37.0	\$ 238.6	\$ 275.6	\$ 300.0	\$ 1.4	N/A	B	
CDO III	December 2004	124.0	175.5	299.5	304.4	5.0	Ba1	BB+	
CDO II	August 2003	400.1		400.1	400.9	6.0	Ba2	BBB-	
CDO I	September 2002	50.2	200.0	250.2	251.7	8.6	Ca	B+	
Total		\$ 611.3	\$ 614.1	\$ 1,225.4	\$ 1,257.0	\$ 21.0			

The carrying values of the Company's retained interest in the CDOs are subject to future volatility in credit, interest rate and prepayment risk. The investment in the preference shares is classified as a trading security in the Company's investment portfolio. Therefore, changes in the market value of these securities are recorded in gain on sales of loans and securities, net in the consolidated statements of income. The following table presents a sensitivity analysis of the Company's retained interests in the CDOs at December 31, 2005 (dollars in thousands):

	CDO I	CDO II	CDO III	CDO IV
Fair value of retained preference shares ⁽¹⁾	\$ 195	\$ 6,288	\$ 5,178	\$ 1,399
Weighted-average remaining life (years)	6.71	2.70	3.84	3.72
Weighted-average prepayment speed	15%	10%	10%	%
Impact of 10% adverse change	\$ (10)	\$ (43)	\$ (98)	\$ (14)
Impact of 20% adverse change	\$ (18)	\$ (85)	\$ (198)	\$ (28)
Weighted-average discount rate	2%	16%	15%	16%
Impact of 10% adverse change	\$ (7)	\$ (257)	\$ (276)	\$ (78)
Impact of 20% adverse change	\$ (10)	\$ (499)	\$ (529)	\$ (150)
Weighted-average expected credit losses	1.95%	0.44%	0.41%	0.65%
Impact of 10% adverse change	\$ (195)	\$ (43)	\$ (22)	\$ (17)
Impact of 20% adverse change	\$ (195)	\$ (86)	\$ (44)	\$ (33)
Actual credit losses to date	\$ 13,056	\$	\$	\$
For the year ended December 31, 2005 ⁽²⁾				
Actual interest payments received	\$	\$ 1,080	\$ 642	\$

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- (1) Based on calculated discounted expected future cash flows, premised on weighted-average life, prepayment speed, discount rate and expected credit losses shown in this table.
- (2) No actual principal payments have been received to-date.

The sensitivities and estimates shown in the preceding table are hypothetical and should be used with the understanding that actual future performance and results can vary significantly. As the sensitivity analysis table shows, changes in the fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this

table, the effect of a variation in a particular assumption on the fair value of the preference shares is calculated without changing any other assumption. Changes in one factor may result in changes in another factor (for example, increases in market interest rates could result in lower prepayments and increased credit losses), which could magnify or counteract the sensitivities.

The Company entered into management agreements to provide certain collateral management services for the CDOs. As compensation for its services, it receives a management fee from the trustee based on the quarterly amount of assets managed (as defined.) During 2005, the Company earned \$4.2 million of management fees under the CDOs.

At December 31, 2005, the Company managed both its on-balance sheet asset-backed securities and the off-balance sheet securitized asset-backed securities of the CDOs, which are presented in the following table (in thousands):

Managed on-balance sheet asset-backed securities, classified as:	
Available-for-sale	\$ 1,365,754
Trading securities	63,956
	<hr/>
Total managed on-balance sheet asset-backed securities	1,429,710
	<hr/>
Managed off-balance sheet securitized asset-backed securities:	
CDO I	104,157
CDO II	280,657
CDO III	284,989
CDO IV	274,599
	<hr/>
Total managed off-balance sheet securitized asset-backed securities	944,402
	<hr/>
Total managed asset-backed securities	\$ 2,374,112
	<hr/>

Securitized Consumer Finance Receivables

The origination and servicing businesses of Consumer Finance Corporation were sold in late 2005. As a result of the sale, the Company retained the consumer receivables and beneficial interests in the trusts. Prior to the sale, Consumer Finance Corporation securitized RV and marine consumer receivables by sales or other transfers to ETCF Asset Funding Corporation through the formation of trusts. There were no securitizations of consumer receivables in 2005. During 2004, Consumer Finance Corporation securitized approximately \$0.3 billion of RV and marine receivables. On October 20, 2003, the Company acquired ETCF Asset Funding Corporation and the retained beneficial interests in four trusts.

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The carrying values of the retained beneficial interests are subject to future volatility in credit, interest rate and prepayment risk. The following table presents a sensitivity analysis of each of portfolio of securitized receivables (dollars in thousands):

	RV	Marine	RV	RV/Marine	RV/Marine
	1999-1⁽¹⁾	1999-2	1999-3	2001-1	2004-1
Fair value of residual investment⁽²⁾					
At December 31, 2005	\$ 7,870	\$ 11,861	\$ 2,021	\$ 2,125	\$ 13,527
At initial value ⁽³⁾	\$ 9,740	\$ 12,775	\$ 4,223	\$ 3,981	\$ 10,877
Weighted-average remaining life (years)	0.08	0.33	1.24	2.24	2.28
Weighted-average prepayment speed	17%	20%	17%	21%	25%
Impact of 10% adverse change	\$ (1)	\$ (1)	\$ 51	\$ 50	\$ (133)
Impact of 20% adverse change	\$ (1)	\$ (2)	\$ 51	\$ 58	\$ (236)
Weighted-average discount rate	9%	9%	9%	9%	16%
Impact of 10% adverse change	\$ (5)	\$ (32)	\$ (21)	\$ (39)	\$ (477)
Impact of 20% adverse change	\$ (11)	\$ (64)	\$ (41)	\$ (77)	\$ (926)
Weighted-average expected credit losses	1.83%	1.58%	1.92%	1.97%	0.48%
Impact of 10% adverse change	\$ (16)	\$ (32)	\$ (106)	\$ (324)	\$ (269)
Impact of 20% adverse change	\$ (32)	\$ (64)	\$ (212)	\$ (590)	\$ (511)
Actual credit losses					
Since trust inception ⁽⁴⁾	\$ 32,346	\$ 10,596	\$ 11,218	\$ 14,557	\$ 624
Since acquisition on October 20, 2003	\$ 6,833	\$ 1,595	\$ 2,957	\$ 6,172	N/A
For the year ended December 31, 2005					
Actual interest payments received	\$ 259	\$ 222	\$ 107	\$ 253	\$
Actual principal payments received	\$ 54	\$ 241	\$ 310	N/A	\$

(1) On December 14, 2005, the Company exercised its option to redeem at par the collateral associated with 1999-1 and receive cash for its residual interest. Payment of the residual interest was received in January 2006.

(2) Based on calculated discounted expected future cash flows, premised on weighted-average life, prepayment speed, discount rate and expected credit losses shown in this table.

(3) Initial value at December 31, 2004 for 2004-1 and October 20, 2003 for all remaining.

(4) Default base on the entire balance of the amount securitized as follows: 1990-1: \$1,000,003; 1992-2: \$550,000; 1999-3: \$374,531; 2001-1: \$529,467; 2004-1: \$308,996.

The sensitivities and estimates shown in the preceding table are hypothetical; actual future performance and results can vary significantly. As the sensitivity analysis table shows, changes in the fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the preference shares is calculated without changing any other assumption. Changes in one factor may result in changes in another factor (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

NOTE 9 SERVICING RIGHTS

The following table shows the net amortized cost of the Company's servicing rights (in thousands):

	December 31,	
	2005	2004
Servicing assets:		
Balance beginning of period	\$ 29,659	\$ 32,773
Purchases (sales) ⁽¹⁾	(4,118)	4,614
Amortization of servicing rights	(8,241)	(7,728)
Balance end of period	17,300	29,659
Valuation allowance for impairment:		
Balance beginning of period	(8,146)	(5,379)
Valuation adjustment ⁽¹⁾	1,872	(2,767)
Balance end of period	(6,274)	(8,146)
Servicing rights, end of period	\$ 11,026	\$ 21,513

⁽¹⁾ Reflects sale of the Consumer Finance business in October 2005. The origination and servicing of RV and marine loans were provided by this business.

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 servicing responsibilities retained by Consumer Finance Corporation for each securitization have been transferred to the purchaser. Prior to the sale, Consumer Finance Corporation received annual servicing fees of 50 basis points of the prior month's balance for the 2004 series trust and all 1999 series trusts and 75 basis points of the prior month's outstanding balance for the 2001 series trust.

The following summarizes the estimated fair values of the Company's servicing assets and significant assumptions (dollars in thousands):

	December 31,	
	2005	2004
Mortgage servicing assets:		
Fair value	\$11,026	\$14,761
Constant prepayment rate	19%	23%
Discount rate	3.5% - 4.0%	1.0% - 1.5%

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Consumer servicing assets:	
Fair value	\$6,752
Constant prepayment rate	21% - 24%
Discount rate	8%

NOTE 10 PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following (in thousands):

	December 31,	
	2005	2004
Software	\$ 353,120	\$ 331,774
Equipment and transportation	193,051	240,517
Leasehold improvements	93,963	88,066
Buildings	71,927	71,927
Furniture and fixtures	19,040	14,340
Land	3,428	3,428
	<hr/>	<hr/>
Total property and equipment, gross	734,529	750,052
Less accumulated depreciation and amortization	(435,273)	(447,761)
	<hr/>	<hr/>
Total property and equipment, net	\$ 299,256	\$ 302,291

Depreciation and amortization expense related to property and equipment was \$75.0 million for 2005, \$77.9 million for 2004 and \$85.6 million for 2003.

Software includes capitalized internally developed software costs. These costs were \$34.7 million for 2005, \$31.8 million for 2004 and \$41.8 million for 2003. Completed projects are carried at cost and are amortized on a straight-line basis over their estimated useful lives, generally four years. Amortization expense for the capitalized amounts was \$31.5 million for 2005, \$33.7 million for 2004 and \$29.3 million for 2003. Also included in software is \$17.6 million of internally developed software in the process of development for which amortization has not begun.

NOTE 11 GOODWILL AND OTHER INTANGIBLES, NET

The following table discloses the changes in the carrying value of goodwill for the periods presented (in thousands):

Balance at December 31, 2003	\$ 392,845
Adjustments to 2002 acquisitions	(11,860)
Adjustments to 2003 acquisitions	15,490
Other adjustments	(1,432)
	<hr/>
Balance at December 31, 2004	395,043
Additions from 2005 acquisitions	1,612,928
Write-off related to discontinued operations	(4,515)
	<hr/>
Balance at December 31, 2005	\$ 2,003,456

The following table discloses the changes in the carrying value of goodwill that occurred in the retail and institutional segments in 2005 (in thousands):

	<u>Retail</u>	<u>Institutional</u>	<u>Total</u>
Balance at December 31, 2004	\$ 153,720	\$ 241,323	\$ 395,043
Additions from 2005 acquisitions	1,611,507	1,421	1,612,928
Write-offs related to discontinued operations	(3,379)	(1,136)	(4,515)
Balance at December 31, 2005	<u>\$ 1,761,848</u>	<u>\$ 241,608</u>	<u>\$ 2,003,456</u>

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Prior periods are not presented, as the Company did not allocate goodwill by its new reporting segments prior to 2005.

The additions to goodwill are the result of our acquisitions during 2005 including *Harrisdirect*, *BrownCo*, *Kobren* and *Howard Capital*. Note 2 has complete descriptions of the transactions. The write-off of goodwill related to discontinued operations was due to the sale of the Consumer Finance Corporation and the exit of *E*TRADE Professional Securities, LLC*. See Note 3 for a complete description of these transactions.

Other intangible assets with finite lives, which are primarily amortized on an accelerated basis, consist of the following (dollars in thousands):

	Weighted-Average Useful Life (Years)	December 31, 2005			December 31, 2004		
		Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Customer list	21	\$ 456,953	\$ (11,592)	\$ 445,361	\$ 10,248	\$ (5,189)	\$ 5,059
Specialist books	28	61,820	(29,280)	32,540	61,820	(8,522)	53,298
Active accounts	8	69,023	(43,234)	25,789	69,023	(36,121)	32,902
Credit cards	15	32,604	(12,496)	20,108	32,672	(4,981)	27,691
Other	5	29,274	(20,964)	8,310	46,859	(31,688)	15,171
Total intangible assets		\$ 649,674	\$ (117,566)	\$ 532,108	\$ 220,622	\$ (86,501)	\$ 134,121

Assuming no future impairments of these assets or additional acquisitions, annual amortization expense will be as follows (in thousands):

Years ending December 31,	
2006	\$ 44,916
2007	42,458
2008	37,667
2009	32,776
2010	30,581
Thereafter	343,710
Total future amortization expense	\$ 532,108

Amortization of other intangibles was \$43.8 million for 2005, \$19.4 million for 2004 and \$24.8 million for 2003.

NOTE 12 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, liabilities 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.

Fair Value Hedges

Overview of Fair Value Hedges

The Company uses a combination of interest rate swaps and purchased options on forward-starting swaps, caps and floors to offset its exposure to changes in value of certain fixed rate assets and liabilities. In calculating the effective portion of fair value hedges under SFAS No. 133, changes in the fair value of the derivative are recognized currently in earnings, as changes in value of the hedged asset attributable to the risk being hedged.

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Accordingly, the net difference or hedge ineffectiveness, if any, is recognized currently in fair value adjustments of financial derivatives in the consolidated statements of income.

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)	
December 31, 2005:								
Pay-fixed interest rate swaps:								
Mortgage-backed securities	\$ 961,000	\$ 12,485	\$ (598)	\$ 11,887	4.50%	4.35%	N/A	4.88
Investment securities	119,485	1,315	(1,750)	(435)	4.62%	4.18%	N/A	7.70
Receive-fixed interest rate swaps:								
Brokered certificates of deposit	132,313		(3,740)	(3,740)	4.33%	5.22%	N/A	12.50
FHLB advances	100,000		(3,894)	(3,894)	4.37%	3.64%	N/A	3.79
Purchased interest rate forward-starting swaps:								
Mortgage-backed securities	70,000		(470)	(470)	5.03%	N/A	N/A	10.01
Purchased interest rate options ⁽¹⁾ :								
Caps	770,000	21,324		21,324	N/A	N/A	4.89%	4.82
Floors	1,325,000	3,952		3,952	N/A	N/A	3.82%	3.71
Swaptions ⁽³⁾	2,241,000	36,982		36,982	N/A	N/A	4.93%	8.47
Total fair value hedges	\$ 5,718,798	\$ 76,058	\$ (10,452)	\$ 65,606	4.51%	4.37%	4.59%	6.29
December 31, 2004:								
Pay-fixed interest rate swaps:								
Mortgage-backed securities	\$ 1,045,000	\$ 3,157	\$ (5,099)	\$ (1,942)	4.42%	2.23%	N/A	6.06
Investment securities	160,885		(3,747)	(3,747)	4.63%	2.09%	N/A	8.83
Receive-fixed interest rate swaps:								
Certificates of deposit	315,000		(1,901)	(1,901)	2.26%	3.39%	N/A	2.90
Brokered certificates of deposit	10,000		(160)	(160)	2.50%	5.00%	N/A	10.01
FHLB advances	100,000		(1,159)	(1,159)	2.40%	3.64%	N/A	4.80
Senior Notes ⁽²⁾	50,000	452		452	5.98%	8.00%	N/A	6.46
Purchased interest rate forward-starting swaps:								
Mortgage-backed securities	209,000	978		978	3.60%	N/A	N/A	3.43
Brokered certificates of deposit	20,000	12	(60)	(48)	5.25%	N/A	N/A	12.55
Purchased interest rate options ⁽¹⁾ :								
Caps	485,000	7,221		7,221	N/A	N/A	6.09%	5.01
Floors	100,000	352		352	N/A	N/A	4.25%	2.75
Swaptions ⁽³⁾	335,000	9,065		9,065	N/A	N/A	5.98%	13.30
Total fair value hedges	\$ 2,829,885	\$ 21,237	\$ (12,126)	\$ 9,111	3.93%	2.71%	5.85%	6.25

(1) Purchased interest rate options were used to hedge mortgage-backed securities.

(2) Interest rate swap agreement on the Company's \$400.0 million senior notes was terminated during 2005.

(3) Swaptions are options to enter swaps starting on a given day.

De-designated Fair Value Hedges

During 2005 and 2004, certain fair value hedges were de-designated; therefore, hedge accounting was discontinued during those periods. The net gain or loss on these derivative instruments at the time of de-designation is amortized to interest expense or interest income over the original forecasted period of the underlying transactions being hedged. Changes in the fair value of these derivative instruments after de-designation of fair value hedge accounting were recorded in gain on sales of loans and securities, net in the consolidated statements of income.

Cash Flow Hedges*Overview of Cash Flow Hedges*

The Company uses a combination of interest rate swaps and purchased options on caps and floors to hedge the variability of future cash flows associated with existing variable-rate liabilities and assets 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 repurchase agreements, FHLB advances and HELOCs are reported in AOCI as unrealized gains or losses. The amounts in AOCI are then included in interest expense or interest income 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 \$2.4 million of net unrealized gains 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 also recognizes cash flow hedge ineffectiveness. Cash flow hedge ineffectiveness is recorded to the extent that the market value of the derivatives used in the hedge relationship underperforms or 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 as fair value adjustment of financial derivatives in the consolidated statements of income. Cash flow ineffectiveness is re-measured on a quarterly basis.

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 (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)
December 31, 2005:								
Pay-fixed interest rate swaps:								
Repurchase agreements	\$ 1,100,000	\$ 6,959	\$ (2,223)	\$ 4,736	4.87%	4.38%	N/A	9.15
Purchased interest rate forward-starting swaps:								
Repurchase agreements	2,675,000	1,219	(19,872)	(18,653)	5.04%	N/A	N/A	9.50
FHLB advances	750,000		(4,040)	(4,040)	5.02%	N/A	N/A	9.46
Purchased interest rate options ⁽¹⁾ :								
Caps	2,925,000	64,301		64,301	N/A	N/A	4.76%	4.59
Floors	1,900,000	2,527		2,527	N/A	N/A	5.50%	3.54
Total cash flow hedges	\$ 9,350,000	\$ 75,006	\$ (26,135)	\$ 48,871	5.00%	4.38%	5.05%	6.71

December 31, 2004:

Pay-fixed interest rate swaps:

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Repurchase agreements	\$ 1,675,000	\$	\$ (33,121)	\$ (33,121)	4.91%	2.28%	N/A	11.12
FHLB advances	425,000		(6,093)	(6,093)	4.68%	2.13%	N/A	9.25
Purchased interest rate forward-starting swaps:								
Repurchase agreement	595,000		(868)	(868)	4.74%	N/A	N/A	11.16
Purchased interest rate options ⁽¹⁾ :								
Caps	2,775,000	94,340		94,340	N/A	N/A	4.43%	6.13
	<u> </u>	<u> </u>	<u> </u>	<u> </u>				
Total cash flow hedges	\$ 5,470,000	\$ 94,340	\$ (40,082)	\$ 54,258	4.84%	2.25%	4.43%	8.45
	<u> </u>	<u> </u>	<u> </u>	<u> </u>				

(1) Caps are used to hedge repurchase agreements and FHLB advances. Floors are used to hedge HELOCs.

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Under SFAS No. 133, we are required to record the fair value of gains and losses on derivatives designated as cash flow hedges in AOCI in the consolidated balance sheets. In addition, during the normal course of business, the Company terminates certain interest rate swaps and options.

The following tables show: 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 and interest income (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Impact on AOCI (net of taxes):			
Beginning balance	\$ (118,018)	\$ (123,754)	\$ (188,280)
Gains (losses) on cash flow hedges related to derivatives, net	7,032	(51,137)	(21,173)
Reclassifications into earnings, net	40,155	56,873	85,699
Ending balance	\$ (70,831)	\$ (118,018)	\$ (123,754)
Derivatives terminated during the year:			
Notional	\$ 17,920,000	\$ 5,423,500	\$ 6,329,500
Fair value of net gains (losses) recognized in AOCI	\$ 2,228	\$ (68,039)	\$ 45,927
Amortization of terminated interest rate swaps and options included in interest expense and interest income	\$ 65,110	\$ 101,807	\$ 125,800

The gains (losses) accumulated in AOCI on the derivative instruments terminated shown in the preceding table will be included in interest expense and interest income over the periods the hedged forecasted issuance of liabilities will affect earnings, ranging from 6 days to 15 years.

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

	At December 31,		
	2005	2004	2003
AOCI balance (net of taxes) related to:			
Open cash flow hedges	\$ (36,736)	\$ (43,027)	\$ (30,775)
Discontinued cash flow hedges	(34,095)	(74,991)	(92,979)
Total cash flow hedges	\$ (70,831)	\$ (118,018)	\$ (123,754)

Hedge Ineffectiveness

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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 fair value adjustments of financial derivatives in the consolidated statements of income. The following table summarizes the income (expense) recognized by the Company as fair value and cash flow hedge ineffectiveness (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Fair value hedges	\$ (4,937)	\$ (3,895)	\$ (19,711)
Cash flow hedges	45	6,194	4,373
	\$ (4,892)	\$ 2,299	\$ (15,338)

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 that 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 performed excludes the market value associated with the anticipated sale of servicing rights related to each loan commitment. The fair value of these IRLCs was a \$1.6 million and \$1.5 million asset at December 31, 2005 and 2004, respectively.

The Company also designates fair value relationships of closed loans held-for-sale against a combination of mortgage forwards and short treasury positions. Short treasury relationships are economic hedges, rather than fair value or cash flow hedges. Short treasury positions are marked-to-market, but do not receive hedge accounting treatment under SFAS No. 133. The mark-to-market of the mortgage forwards are included in the net change of the IRLCs and the related hedging instruments. The mark-to-market of the closed loans recorded for 2005 and 2004 were \$0.7 million and \$4.3 million, respectively.

IRLCs, as well as closed loans held-for-sale, 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 as gain on sales of loans and securities, net in the consolidated statements of income. The net change in IRLCs, closed loans and the related hedging instruments generated a net loss of \$0.4 million in 2005 and a net gain of \$3.9 million in 2004.

Credit risk is managed by limiting activity to approved counterparties and setting aggregate exposure limits for each approved counterparty. The credit risk that results from interest rate swaps and purchased interest rate options is represented by the fair value of contracts that have unrealized gains at the reporting date. Conversely, we have \$36.6 million of derivative contracts with unrealized losses at December 31, 2005. These agreements required the Company to pledge approximately \$7.4 million of its mortgage-backed and investment securities as collateral.

While the Company does not expect that any counterparty will fail to perform, the following table shows the maximum exposure, or net credit risk, associated with each counterparty to interest rate swaps and purchased interest rate options at December 31, 2005 (in thousands):

<u>Counterparty</u>	<u>Credit Risk</u>
Union Bank of Switzerland	\$ 27,733
Lehman Brothers	12,821
Royal Bank of Scotland	7,283
Bank of America	5,361
Credit Suisse First Boston	4,446
Other	1,316
Total exposure	\$ 58,960

NOTE 13 OTHER ASSETS

Other assets consist of the following (in thousands):

	December 31,	
	2005	2004
Third party loan servicing receivable	\$ 79,264	\$ 3,806
Other investments	65,189	46,269
Unamortized debt issue costs	36,088	9,134
Prepays	26,239	25,947
Deferred compensation plan	18,419	11,974
Servicing rights	11,026	21,513
Securities sold, collateral not delivered	9,024	53,152
Deferred tax assets	3,851	41,119
Other	96,577	42,633
Total other assets	\$ 345,677	\$ 255,547

Other Investments

The Company has made investments in low income housing tax credit partnerships (LIHTC), venture funds and several non-public, venture capital-backed, high technology companies. The Company recorded no other-than-temporary impairments for 2005 and 2004 and \$8.0 million for 2003, associated with these privately held equity investments. These impairments are recorded in gain on sale and impairment of investments in the consolidated statements of income. The Company has \$45.3 million in commitments in to fund LIHTC, venture funds and joint ventures.

Securities Sold, Collateral Not Delivered

The Bank has receivables for mortgage-backed securities from third-party brokers that the Bank committed to sell, but did not deliver to the brokers by the settlement date. The Bank was unable to deliver the securities primarily because other parties failed to deliver similar securities to the Bank, which the Bank had committed to buy. Securities sold, collateral not delivered for the brokerage subsidiaries are included in brokerage receivables.

NOTE 14 DEPOSITS

Deposits are summarized as follows (dollars in thousands):

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	Weighted-Average		Amount		Percentage	
	Rate				to Total	
	December 31,		December 31,		December 31,	
	2005	2004	2005	2004	2005	2004
Sweep deposit account	0.57%	0.40%	\$ 7,733,267	\$ 6,167,436	48.5%	50.1%
Money market and savings accounts	3.17%	1.52%	4,635,866	3,340,936	29.1	27.2
Certificates of deposit	3.94%	3.40%	2,703,605	2,069,674	17.0	16.8
Brokered certificates of deposit	3.86%	2.51%	484,612	294,587	3.0	2.4
Checking accounts	0.71%	0.66%	390,665	430,341	2.4	3.5
Total deposits	2.00%	1.27%	\$ 15,948,015	\$ 12,302,974	100.0%	100.0%

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Deposits, classified by rates are as follows (in thousands):

		December 31,	
		2005	2004
0.00% 1.99%		\$ 8,488,981	\$ 10,448,712
2.00% 3.99%		5,158,261	1,160,915
4.00% 5.99%		2,278,914	435,972
6.00% 9.99%		27,633	257,504
Subtotal		15,953,789	12,303,103
Fair value adjustments		(5,774)	(129)
Total deposits		\$ 15,948,015	\$ 12,302,974

At December 31, 2005, scheduled maturities of certificates of deposit and brokered certificates of deposit were as follows (in thousands):

	< 1 Year	1-2 Years	2-3 Years	3-4 Years	4-5 Years	> 5 Years	Total
Less than 4.00%	\$ 1,510,063	\$ 167,249	\$ 89,571	\$ 10,407	\$ 1,149	\$ 5,683	\$ 1,784,122
4.00% 5.99%	827,242	234,685	76,006	59,129	85,552	99,960	1,382,574
6.00% 7.99%	3,680	984	1,314	470	384	20,463	27,295
Subtotal	\$ 2,340,985	\$ 402,918	\$ 166,891	\$ 70,006	\$ 87,085	\$ 126,106	3,193,991
Fair value adjustments							(5,774)
Total certificates of deposit and brokered certificates of deposit							\$ 3,188,217

Scheduled maturities of certificates of deposit and brokered certificates of deposit with denominations greater than or equal to \$100,000 were as follows (in thousands):

		December 31,	
		2005	2004
Three months or less		\$ 319,609	\$ 216,671
Three through six months		226,040	75,990
Six through twelve months		266,840	174,049
Over twelve months		307,885	237,533
Total certificates of deposit		\$ 1,120,374	\$ 704,243

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Interest expense on deposits is summarized as follows (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Sweep deposit account	\$ 36,147	\$ 13,226	\$ 1,313
Money market and savings accounts	89,073	47,297	73,634
Certificates of deposit	88,733	110,577	185,574
Brokered certificates of deposit	15,679	9,172	10,147
Checking accounts	2,679	2,408	2,496
Total interest expense	\$ 232,311	\$ 182,680	\$ 273,164

Accrued interest payable on these deposits, which is included in accounts payable, accrued and other liabilities, was \$11.6 million at December 31, 2005 and \$5.1 million at December 31, 2004.

The Sweep Deposit Account (SDA) is a sweep product that transfers brokerage customer balances. The Bank holds these funds as customer deposits in Federal Deposit Insurance Corporation (FDIC)-insured Negotiable Order of Withdrawal (NOW) and money market deposit accounts.

NOTE 15 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND OTHER BORROWINGS BY BANK SUBSIDIARY

The maturities of borrowings at December 31, 2005 and total borrowings at December 31, 2004 are shown below (dollars in thousands):

	Repurchase Agreement	Other Borrowings by Bank Subsidiary		Total	Weighted Average Interest Rate
		FHLB Advances	Other		
Due in:					
2006	\$ 9,746,122	\$ 1,910,000	\$ 5,440	\$ 11,661,562	4.20%
2007	50,478	700,000		750,478	4.45%
2008		50,000		50,000	3.82%
2009	100,145	96,106		196,251	3.15%
2010		100,000		100,000	4.38%
Thereafter	1,204,797	1,000,000	305,046	2,509,843	3.80%
Total borrowings at December 31, 2005	\$ 11,101,542	\$ 3,856,106	\$ 310,486	\$ 15,268,134	4.13%
Total borrowings at December 31, 2004	\$ 9,897,191	\$ 1,487,841	\$ 272,891	\$ 11,657,923	2.17%

Securities Sold Under Agreements to Repurchase

The Company sells securities under agreements to repurchase similar securities (Repurchase Agreements). Repurchase Agreements are collateralized by fixed- and variable-rate mortgage-backed securities or investment grade securities. Repurchase Agreements are treated as financings for financial statement purposes and obligations to repurchase securities sold are reflected as borrowings in the consolidated balance sheets. The brokers retain possession of the securities collateralizing the repurchase agreements until maturity. At December 31, 2005, there were no counterparties with whom the Company's amount at risk exceeded 10% of its shareholders' equity.

Other Borrowings by Bank Subsidiary

FHLB Advances The Company had \$2.2 billion floating-rate and \$1.7 billion fixed-rate FHLB advances at December 31, 2005. The floating-rate advances adjust quarterly based on the LIBOR. The Company is required to be a member of the FHLB System and maintain a FHLB investment at least equal to the greater of: one percent of the unpaid principal balance of its residential mortgage loans; one percent of 30 percent of its total assets; or one-twentieth of its outstanding FHLB advances. In addition, the Company must maintain qualified collateral equal to 85 to 90 percent of its advances, depending on the collateral type. These advances are secured with specific mortgage loans and mortgage-backed securities. At December 31, 2005 and 2004, the Company pledged \$9.3 billion and \$3.4 billion, respectively, of the one- to four-family first-mortgage loans, HELOCs and second mortgage loans as collateral.

Other ETB Holdings (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 issued Floating Rate Cumulative Preferred Securities, at par with a liquidation amount of \$1,000 per capital security. ETBH uses the proceeds from the sale of issuances to purchase Floating Rate Junior Subordinated Debentures issued by ETBH, guarantees the trust obligations and contributes proceeds from the sale of its subordinated debentures to the Bank in the form of a capital contribution.

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During 2005, ETBH formed two trusts, ETBH Capital Trust XXI and ETBH Capital Trust XXII. These two trusts issued 20,000 shares and 30,000 shares, respectively, of Floating Rate Cumulative Preferred Securities for a total of \$20 million and \$30 million, respectively. Net proceeds from these issuances were invested in Floating Rate Junior Subordinated Debentures that mature in 2035 and have variable rates of 2.40% and 2.20%, respectively, above the three-month LIBOR, payable quarterly.

The face values of outstanding trusts at December 31, 2005 are shown below (dollars in thousands):

Trusts	Face Value	Maturity	
		Date	Annual Interest Rate
Telebank Capital Trust I	\$ 9,000	2027	11.00%
ETBH Capital Trust II	\$ 5,000	2031	10.25%
ETBH Capital Trust I, III	\$ 35,000	2031	3.75% above 6-month LIBOR
ETBH Capital Trust V VIII	\$ 66,000	2032	3.25%-3.65% above 3-month LIBOR
ETBH Capital Trust IV	\$ 10,000	2032	3.70% above 6-month LIBOR
ETBH Capital Trust IX XII	\$ 50,000	2033	3%-3.25% above 3-month LIBOR
ETBH Capital Trust XIII XVIII, XX	\$ 77,000	2034	2.45%-2.90% above 3-month LIBOR
ETBH Capital Trust XIX, XXI, XXII	\$ 60,000	2035	2.20%-2.4% above 3-month LIBOR

Other borrowings also includes \$5.4 million of overnight and other short-term borrowings from the Federal Reserve Bank in connection with the Federal Reserve Bank's special direct investment and treasury, tax and loan programs. The Company pledged \$0.5 billion of securities and RV loans to secure these borrowings.

Below is additional information regarding borrowings (in thousands):

	December 31,	
	2005	2004
Weighted-average balance during the year (calculated on a daily basis)	\$ 10,115,764	\$ 8,139,736
Weighted-average interest rate:		
During the year (calculated on a daily basis)	3.70%	3.18%
At year-end	4.15%	2.15%
Maximum month-end balance during the year	\$ 11,412,028	\$ 10,285,738
Balance at year-end	\$ 11,412,028	\$ 10,170,082
Securities and loans underlying the repurchase agreements at the end of the year:		
Carrying value, including accrued interest	\$ 11,665,421	\$ 10,001,607
Estimated market value	\$ 11,325,412	\$ 9,958,744

NOTE 16 CORPORATE DEBT

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

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	December 31,	
	2005	2004
Senior notes:		
8.00% Notes, due 2011	\$ 504,407	\$ 400,452
7 ³ / ₈ % Notes, due 2013	597,540	
7 ⁷ / ₈ % Notes, due 2015	300,000	
	<u>1,401,947</u>	<u>400,452</u>
Total senior notes	1,401,947	400,452
Mandatory convertible notes 6 ¹ / ₈ %, due 2018	435,589	
Convertible subordinated notes 6.00%, due 2007	185,165	185,165
	<u>2,022,701</u>	<u>585,617</u>
Total corporate debt	\$ 2,022,701	\$ 585,617

8.00% Senior Notes Due June 2011

In 2005 and 2004, the Company issued an aggregate principal amount of \$100 million and \$400 million in senior notes due June 2011 (the 8.00% Notes), respectively. Interest is payable semi-annually and notes 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 \$1.5 million are included in other assets and are being amortized over the term of the senior notes.

7³/₈% Senior Notes due September 2013

In 2005, the Company issued an aggregate principal amount of \$600 million in senior notes due September 2013 (the 7³/₈% Notes). Interest is payable semi-annually and the notes 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 \$8.5 million are included in other assets and are being amortized over the term of the notes.

7⁷/₈% Senior Notes Due December 2015

In 2005, the Company issued an aggregate principal amount of \$300 million in senior notes due December 2015 (the 7⁷/₈% Notes). Interest is payable semi-annually and the notes 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 \$3.7 million are included in other assets and are being amortized over the term of the notes.

All senior notes are unsecured and will rank equal in right of payment with all of the Company's existing and future unsubordinated indebtedness and will rank senior in right of payment to all our existing and future subordinated indebtedness.

6¹/₄% Mandatory Convertible Notes Due November 2018

In November 2005, the Company issued 18.0 million of mandatory convertible notes (Units) with a face value of \$450 million. Each Unit consists of a purchase contract and a 6¹/₈% senior note. The Company recorded the purchase contracts and senior notes at fair value, with \$15 million recorded in equity and \$435 million in debt, respectively.

Each purchase contract obligates the holder to purchase, and the Company to sell, at a purchase price of \$25.00 in cash, a variable number of shares of the Company's common stock. The stock conversion ratio varies depending on the average closing price of the Company's common stock over a 20-day trading period ending on the third trading day immediately preceding November 18, 2008 (Reference Price). If the Reference Price is equal to or greater than \$21.816 per share, the settlement rate will be 1.1459 shares of common stock. If the Reference Price is less than \$21.816 per share but greater than \$18.00 per share, the settlement rate is equal to \$25.00 divided by the Reference Price. If the Reference Price is less than or equal to \$18.00 per share, the settlement rate will be 1.3889 shares of common stock. The Company is obligated under the purchase contract to sell shares of its common stock under the agreement in November 2008. In November 2008, the aggregate principal amount of the senior notes will be remarketed, which may result in a change in the interest rate and maturity date of the senior notes.

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Before the Purchase Date, the Units will be reflected in diluted earnings per share calculations using the treasury stock method as defined by SFAS No. 128, *Earning per Share*. Under this method, the number of shares of common stock used in calculating diluted earnings per share (based on the settlement formula applied at the end of the reporting period) is deemed to be increased by the excess, if any, of the number of shares that would be issued upon settlement of the purchase contracts less the number of shares that could be purchased by the Company in the market at the average market price during the period using the proceeds to be received upon settlement. Therefore, dilution will occur for periods when the average market price of the Company's common stock for the reporting period is above \$21.816.

6.00% Convertible Subordinated Notes Due February 2007

In 2000, the Company issued an aggregate principal amount of \$650 million of the 6.00% convertible subordinated notes due February 2007 (the 6.00% Notes). The 6.00% Notes are convertible, at the option of the holder, into common stock at a conversion price of \$23.60 per share (7.8 million shares based on the \$185.2 million principal amount of notes outstanding at December 31, 2005.) The notes bear interest at 6.00%, payable semiannually, and are non-callable for three years and may then be called by the Company at a premium, which declines over time. The holders have the right to require redemption at a premium in the event of a change in control or other defined redemption events. Debt issuance costs of \$19.1 million were incurred in connection with the issuance of this debt and included in other assets. To date, the Company has retired or called \$464.8 million of the 6.00% Notes.

Senior Secured Revolving Credit Facility

In September 2005, the Company entered into a \$250 million, three-year senior secured revolving credit facility. The facility is secured by certain assets of the Company. The facility will be used for general corporate purposes, including regulatory capital needs arising from acquisitions. Draws under the facility currently bear interest, at our option, at adjusted LIBOR plus 2% or prime plus 1%. Undrawn facility funds currently bear commitment fees of 0.25% per annum payable quarterly in arrears. At December 31, 2005, no amounts were outstanding under this credit facility. Issuance costs of \$2.2 million are included in other assets and are being amortized over the term of the facility.

Corporate Debt Covenants

Certain of the Company's corporate senior debt described above have terms which include customary financial covenants. As of December 31, 2005, the Company was in compliance with all such covenants.

Early Extinguishment of Debt

The Company recorded a \$19.4 million loss on early extinguishment of debt in 2004. In 2004, loss on early extinguishment of debt included a \$12.6 million loss from the retirement of a portion of our 6.75% convertible subordinated notes and \$6.8 million loss from the retirement of the 6.00% Notes, both charges relating to the portion of the premium paid and write-off of unamortized debt offering costs. In 2005, the Company did not have any early extinguishments of debt.

NOTE 17 ACCOUNTS PAYABLE, ACCRUED AND OTHER LIABILITIES

Accounts payable, accrued and other liabilities consist of the following (in thousands):

December 31,	
2005	2004

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Accounts payable and accrued expenses	\$ 272,402	\$ 224,989
Notes payable	66,953	40,393
Restructuring liabilities and purchase accounting accruals	52,808	33,049
Subserviced loan advances	27,565	14,360
Senior and convertible debt accrued interest	24,396	6,021
Margin call collaterals	21,837	36,097
Securities purchased collateral not delivered	9,135	53,131
Income tax payable		53,937
Other	100,449	124,790
Total accounts payable, accrued and other liabilities	\$ 575,545	\$ 586,767

Securities Purchased, Collateral Not Received

The Bank has payables to third-party brokers for mortgage-backed securities that the Bank committed to buy, but did not receive from the brokers by December 31, 2005 and 2004.

Notes Payable

The Company maintains committed and uncommitted financing facilities with banks totaling \$825 million to meet corporate liquidity needs and finance margin lending. There was none outstanding under these lines at December 31, 2005 and 2004. The Company also has multiple term loans from financial institutions. These loans are collateralized by equipment. Borrowings under these term loans bear interest at 5.43% and 2.95% above LIBOR. The Company had approximately \$40.5 million of principal outstanding under these loans at December 31, 2005.

NOTE 18 INCOME TAXES

The components of income tax expense from continuing operations are as follows (in thousands)

	Year Ended December 31,		
	2005	2004	2003
Current:			
Federal	\$ 158,050	\$ 95,862	\$ 80,302
Foreign	3,518	4,442	5,894
State	19,237	14,540	18,390
Total current	180,805	114,844	104,586
Deferred:			
Federal	45,200	44,086	(5,368)
Foreign	(1,264)	2,328	5,418
State	5,082	20,506	6,965
Total deferred	49,018	66,920	7,015
Income tax expense from continuing operations	\$ 229,823	\$ 181,764	\$ 111,601

The Company is subject to examination by the Internal Revenue Service (the IRS), taxing authorities in foreign countries and states in which the Company has significant business operations. The Company regularly assesses the likelihood of additional tax deficiencies in each of the taxing jurisdictions resulting from ongoing and subsequent years' examinations. Included in current tax expense are charges to accruals for expected tax contingencies in accordance with SFAS No. 5.

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The components of income before income taxes and discontinued operations are as follows (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Domestic	\$ 653,131	\$ 545,197	\$ 308,901
Foreign	22,995	19,290	(1,840)
Total income before income taxes and discontinued operations	\$ 676,126	\$ 564,487	\$ 307,061

Deferred income taxes are recorded when revenues and expenses are recognized in different periods for financial statement and tax return purposes. The temporary differences and tax carry-forwards that created deferred tax assets and deferred tax liabilities are as follows (in thousands):

	December 31,	
	2005	2004
Deferred tax assets:		
Reserves and allowances	\$ 20,826	\$ 15,237
Net unrealized gain on equity investments and Bank assets held-for-sale	109,871	78,411
Net operating loss carry-forwards	59,433	68,939
Deferred compensation	13,613	9,235
Capitalized technology development	4,739	7,382
Tax credits		6,520
Restructuring reserve and related write-downs	56,805	66,116
Other		1,225
Total deferred tax assets	265,287	253,065
Deferred tax liabilities:		
Internally developed software	(20,925)	(20,690)
Acquired intangibles	(21,759)	(36,552)
Basis differences in investments	(117,642)	(53,007)
Loan fees	(6,966)	(7,092)
Depreciation and amortization	(32,232)	(28,753)
Purchased software	(3,024)	(3,024)
Retained servicing rights	(2,755)	(6,298)
Other	(16,774)	(3,859)
Total deferred tax liabilities	(222,077)	(159,275)
Valuation allowance	(39,359)	(52,671)
Net deferred tax asset	\$ 3,851	\$ 41,119

The Company maintains a valuation allowance of \$39.4 million and \$52.7 million at December 31, 2005 and 2004, respectively, against certain of its deferred tax assets, as it is more likely than not that they will not be fully realized. The deferred tax assets for which a valuation allowance has been established include certain state and foreign country net operating loss carry-forwards and excess tax bases in certain illiquid investments.

At December 31, 2005, the Company had foreign country net operating loss carry-forwards of approximately \$83.0 million for which a deferred tax asset of approximately \$25 million was established. The foreign net operating losses represent the foreign tax loss carry-forwards in numerous foreign countries, some of which are subject to expiration from 2006-2008. In most of these foreign countries, the Company has historical tax losses, and the Company continues to project to incur operating losses in most of these countries. Accordingly, the Company has provided a valuation allowance of \$23.5 million against such deferred tax asset at December 31, 2005.

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During 2005, the Company reversed the valuation allowance of approximately \$2.0 million related to its Danish subsidiary's operations due to positive evidence, principally sustained profitability, that led management to conclude that it is now more likely than not that realization of its net operating losses and other tax attributes will be recognized.

At December 31, 2005, the Company had gross state net operating loss carry-forwards of \$171 million that expire between 2012 and 2024, most of which are subject to reduction for apportionment when utilized. A deferred tax asset of approximately \$13 million has been established related to these state net

operating loss carry-forwards with a valuation allowance of \$2 million against such deferred tax asset at December 31, 2005.

At December 31, 2005, the Company maintains a valuation allowance against the excess tax basis in certain capital assets of approximately \$11 million. The capital assets in question are certain investments in e-commerce and Internet startup venture funds that have no ready market or liquidity at December 31, 2005. The Company has concluded that the realization of these excess tax benefits on these capital assets are uncertain and not in the control of the Company, as there is no ready market or liquidity for these investments.

The valuation allowance was decreased in 2005 for the elimination of a valuation allowance of \$7 million related to foreign tax credits when the corresponding deferred tax asset was written off upon the conversion of all outstanding Exchangeable Shares to the Company's common stock. The elimination of the valuation allowance did not impact income tax expense.

The majority of the balance of the reduction in the valuation allowance of approximately \$5 million related to foreign net operating loss carry-forwards and other foreign deferred tax items.

At December 31, 2005, the Company had federal net operating loss carry-forwards of approximately \$59 million for which no valuation allowance has been provided. These carry-forwards expire through 2020. These federal net operating loss carry-forwards relate to pre-acquisition losses from acquired subsidiaries and, accordingly, are generally subject to annual limitations in their use of \$4.9 million per year in accordance with Internal Revenue Code Section 382. Accordingly, the extent to which the loss carry-forwards can be used to offset future taxable income may be limited.

The Company has not provided deferred income taxes on \$31 million of undistributed earnings and profits in its foreign subsidiaries at December 31, 2005. The Company intends to permanently reinvest such earnings. The Company has not provided deferred income taxes of \$10.9 million on such undistributed earnings and profits. The American Jobs Creation Act of 2004 (the Act) provided for a temporary incentive for U.S. multinational corporations to repatriate accumulated income earned abroad by providing an 85% exclusion from taxable income for certain dividends from controlled foreign corporations. As a result of this special temporary tax incentive, the Company distributed \$20 million from its Canadian subsidiaries in 2004. The Company did not record any cumulative tax expense in connection with such repatriation since the Company believes the distribution was a tax-free return of capital for tax purposes.

The effective tax rates differed from the Federal statutory rates as follows:

	Year Ended December 31,		
	2005	2004	2003
Federal statutory rate	35.0 %	35.0 %	35.0 %
State income taxes, net of Federal tax benefit	2.3	4.4	3.6
Difference between statutory rate and foreign effective tax rate and establishment of valuation allowance for foreign deferred tax assets	(0.9)	(0.7)	3.8
IRS tax settlement		(2.8)	
Excess tax basis upon sale of partnership interests		(2.2)	
Change in valuation allowance	(0.3)	(0.5)	(5.2)
Other	(2.1)	(1.0)	(0.9)
	<u> </u>	<u> </u>	<u> </u>
Effective tax rate	34.0 %	32.2 %	36.3 %
	<u> </u>	<u> </u>	<u> </u>

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The increase to our 2005 tax rate was principally due to the one-time tax benefits recorded in 2004 related to (i) the IRS tax settlement and (ii) the excess tax basis upon the sale of partnership interests, offset somewhat by our declining state tax rate and overall foreign tax rate differential. In 2004, the Company reached a favorable tax

settlement with the IRS. This agreement resolved various issues for all federal tax liabilities through 2000, including most notably certain research and experimentation credit claims.

NOTE 19 SHAREHOLDERS' EQUITY

Preferred Stock

The Company has 1.0 million shares authorized in preferred stock. None were issued and outstanding at December 31, 2005 and 2004.

Shares Exchangeable into Common Stock

At December 31, 2005, there were no shares of common stock that were exchangeable into the Company's common stock (Exchangeable Shares) outstanding. In August 2000, EGI Canada Corporation issued approximately 9.4 million Exchangeable Shares in connection with the Company's acquisition of E*TRADE Technologies. In 2005, the Company called and exchanged the remaining Exchangeable Shares. Upon exchange, these shares were converted on a one-for-one basis to the Company's common stock. Exchangeable Shares converted were 1.3 million in 2005, 0.1 million in 2004 and 0.2 million in 2003.

Issuance of Common Stock

In 2005, the Company issued \$718.4 million or 41.1 million shares of common stock including \$691.8 million sold in conjunction with the funding of our BrownCo acquisition.

Mandatory Convertible Notes

In November 2005, the Company issued 18.0 million Units that are convertible into up to 25.0 million shares of common stock, on or before the Purchase Date. The conversion ratio depends on the market price of our common stock 20 trading days prior to conversion. Units are generally convertible only on or near the Purchase Date. (See Note 16 for additional details on the transaction.)

Share Repurchases

From time to time, the Company's Board of Directors authorizes share repurchase and debt retirement plans, as they determine that they are likely to create long-term value for its shareholders. These plans are open-ended and provide 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. Under these authorized plans, the Company has repurchased common stock and retired portions of its convertible subordinated notes.

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In 2005, the Company repurchased nearly 4.6 million shares of its common stock for an aggregate \$58.2 million. In 2004, the Company repurchased 13.7 million shares of its common stock for an aggregate \$175.8 million. Also under the repurchase plans, the Company used \$86.2 million in cash for a partial redemption of its 6.75% convertible subordinated notes.

As of December 31, 2005, the Company had approximately \$179.8 million available under its authorized share repurchase and debt retirement plans to purchase additional shares of its common stock or retire additional debt.

NOTE 20 INCOME PER SHARE

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

	Year Ended December 31,		
	2005	2004	2003
<u>BASIC:</u>			
Numerator:			
Income from continuing operations	\$ 446,238	\$ 381,830	\$ 200,521
Net income (loss) from discontinued operations	(17,472)	(1,347)	2,506
	<u>428,766</u>	<u>380,483</u>	<u>203,027</u>
Net income before cumulative effect of accounting change	428,766	380,483	203,027
Cumulative effect of accounting change, net of tax	1,646		
	<u>430,412</u>	<u>380,483</u>	<u>203,027</u>
Net income	\$ 430,412	\$ 380,483	\$ 203,027
Denominator:			
Basic weighted-average shares outstanding	371,468	366,586	358,320
	<u>371,468</u>	<u>366,586</u>	<u>358,320</u>
<u>DILUTED:</u>			
Numerator:			
Net income	\$ 430,412	\$ 380,483	\$ 203,027
Interest on convertible subordinated notes, net of tax		19,963	
	<u>430,412</u>	<u>400,446</u>	<u>203,027</u>
Net income, as adjusted	\$ 430,412	\$ 400,446	\$ 203,027
Denominator:			
Basic weighted-average shares outstanding	371,468	366,586	358,320
Effect of dilutive securities:			
Weighted-average options and restricted stock issued to employees	11,137	10,461	6,495
Weighted-average warrants and contingent shares outstanding	2,025	2,532	2,546
Shares issuable for assumed conversion of convertible subordinated notes		25,810	
	<u>384,630</u>	<u>405,389</u>	<u>367,361</u>
Diluted weighted-average shares outstanding	384,630	405,389	367,361
<u>PER SHARE:</u>			
Basic Income Per Share:			
Income per share from continuing operations	\$ 1.20	\$ 1.04	\$ 0.56
Net income (loss) per share from discontinued operations	(0.04)	(0.00)	0.01
	<u>1.16</u>	<u>1.04</u>	<u>0.57</u>
Net income per share before cumulative effect of accounting changes	1.16	1.04	0.57
Cumulative effect of accounting change	0.00		
	<u>1.16</u>	<u>1.04</u>	<u>0.57</u>
Income per share	\$ 1.16	\$ 1.04	\$ 0.57
Diluted Income Per Share:			
Income per share from continuing operations	\$ 1.16	\$ 0.99	\$ 0.55
Net income (loss) per share from discontinued operations	(0.04)	(0.00)	0.00
	<u>1.12</u>	<u>0.99</u>	<u>0.55</u>
Net income per share before cumulative effect of accounting change	1.12	0.99	0.55

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Cumulative effect of accounting change	0.00		
Net income per share	\$ 1.12	\$ 0.99	\$ 0.55

Excluded from the calculations of diluted income (loss) per share are 7.8 million and 45.4 million shares of common stock for 2005 and 2003, respectively, issuable under convertible subordinated notes as the effect of applying the treasury stock method on an if-converted basis would be anti-dilutive. In addition, in 2005, 25.0 million shares of common stock potentially issuable related to the conversion of mandatory convertible notes was excluded from the calculations because it would be anti-dilutive.

The following options to purchase shares of common stock have not been included in the computation of diluted income per share because the options' exercise price was greater than the average market price of the Company's common stock for the following years stated, therefore, the effect would be anti-dilutive (in thousands, except exercise price ranges):

	Year Ended December 31,		
	2005	2004	2003
Options excluded from computation of diluted income per share	7,209	10,665	14,860
Exercise price ranges:			
High	\$ 58.19	\$ 58.19	\$ 58.19
Low	\$ 12.76	\$ 12.50	\$ 7.97

NOTE 21 EMPLOYEE SHARE-BASED PAYMENTS AND OTHER BENEFITS

Adoption of SFAS No. 123(R)

As discussed in Note 1, effective July 1, 2005, the Company early adopted SFAS No. 123(R.) The adoption resulted in the recognition of or changes to the recognition method of expense for the Company's employee stock option plans, restricted stock awards and employee stock purchase plan. The combined impact of the adoption in 2005 is as follows: \$13.7 million in compensation expense for stock options; \$0.4 million compensation expense for the stock purchase plan; and a pre-tax credit of \$2.8 million in cumulative effect of accounting change for 2005. Results for prior periods have not been restated. Total compensation expense for stock-based compensation also includes \$4.2 million for restricted stock awards, which were previously expensed by the Company under APB No. 25, prior to the adoption of SFAS No. 123(R).

Employee Stock Option Plans

In 2005, the Company adopted and the shareholders approved the 2005 Stock Incentive Plan (the "2005 Plan") to replace the 1996 Stock Incentive Plan (the "1996 Plan") which provides for the grant of nonqualified or incentive stock options to officers, directors, key employees and consultants for the purchase of newly issued shares of the Company's common stock at a price determined by the Board of Directors (the "Board") at the date the option is granted. Options are generally exercisable ratably over a four-year period from the date the option is granted and expire within ten years from the date of grant. Certain options provide for accelerated vesting upon a change in control. Exercise prices are generally equal to the fair market value of the shares on the grant date. A total of 85.4 million shares have been authorized under the 2005 Plan since inception and 36.6 million shares were available for grant at December 31, 2005.

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton option pricing model based on the assumptions noted in the table below. Expected volatility is based on a combination of historical volatility of the Company's stock and implied volatility of publicly traded options on the Company's stock. The expected term represents the period of time that options granted are expected to be outstanding. The expected term is estimated using employees' actual historical behavior and projected future behavior based on expected exercise patterns. The risk-free interest rate is based on the U.S. Treasury zero-coupon bond where the remaining term equals the expected term. Dividend yield is zero as the Company has not, nor does it currently plan to, issue dividends to its shareholders.

Year Ended December 31,

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	2005	2004	2003
Expected volatility	34%	55%	66%
Expected term (years)	4.9	4.3	3.3
Risk-free interest rate	4%	3%	3%
Dividend yield			

The weighted-average fair values of options granted were \$4.57 for 2005, \$5.95 for 2004 and \$2.83 for 2003. Intrinsic value of options exercised were \$67.0 million for 2005, \$53.1 million for 2004 and \$30.9 million for 2003.

A summary of option activity under the 2005 Plan is presented below:

	Shares (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2004:	42,789	\$ 9.68		
Granted	6,856	\$ 12.80		
Exercised	(7,780)	\$ 6.84		
Canceled	(4,699)	\$ 13.36		
Outstanding at December 31, 2005	37,166	\$ 10.37	6.76	\$ 389,766
Exercisable at December 31, 2005	21,217	\$ 9.31	5.74	\$ 244,988

As of December 31, 2005, there was \$31.3 million of total unrecognized compensation cost related to non-vested options. This cost is expected to be recognized over a weighted-average period of 2.2 years. The total fair value of shares vested was \$39.8 million for 2005, \$60.5 million for 2004 and \$122.2 for 2003.

Restricted Stock Awards

The Company recorded \$4.2 million for 2005, \$4.7 million for 2004 and \$2.3 million for 2003 in compensation expense relating to restricted stock awards. In addition, the Company recorded a pre-tax credit of \$2.8 million in cumulative effect of accounting change as a result of adopting SFAS No. 123(R) in 2005.

The Company issues restricted stock awards to its officers and senior executives. These awards are issued at the fair market value on the date of grant and generally vest ratably over four years. However, certain awards vest on the fifth anniversary of the date of grant. The fair value is calculated as the market price upon issuance.

Prior to its adoption of SFAS No. 123(R), the Company recorded compensation expense for restricted stock awards on a straight-line basis over their vesting period. If an employee forfeited the award prior to vesting, the Company reversed out the previously expensed amounts in the period of forfeiture. As required upon adoption of SFAS No. 123(R), the Company must base its accruals of compensation expense on the estimated number of awards for which the requisite service period is expected to be rendered. Actual forfeitures are no longer recorded in the period of forfeiture. The Company recorded a pre-tax credit of \$2.8 million in cumulative effect of accounting change, that represents the amount by which compensation expense would have been reduced in periods prior to adoption of SFAS No. 123(R) for restricted stock awards outstanding on July 1, 2005 that are anticipated to be forfeited.

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Under the provision of SFAS No. 123(R), the recognition of deferred stock compensation, a contra-equity account representing the amount of unrecognized restricted stock expense is no longer required. Therefore, as of July 1, 2005, Deferred Stock Compensation was combined with Additional Paid-in Capital in the Company's consolidated balance sheet.

A summary of non-vested restricted stock award activity is presented below:

	Shares (in thousands)	Weighted- Average Grant Date Fair Value
Non-vested at December 31, 2004:	2,615	\$ 9.35
Issued	830	\$ 11.93
Released (vested)	(276)	\$ 10.31
Canceled	(516)	\$ 9.18
Non-vested at December 31, 2005	2,653	\$ 10.09

As of December 31, 2005, there was \$14.0 million of total unrecognized compensation cost related to non-vested awards. This cost is expected to be recognized over a weighted-average period of 2.9 years.

Employee Stock Purchase Plan

For the year ended December 31, 2005, the Company recorded \$0.4 million in compensation expense for its employee stock purchase plan. Effective August 1, 2005, the Company changed the terms of its purchase plan to reduce the discount to 5% and discontinued the look-back provision. As a result, the purchase plan was not compensatory beginning August 1, 2005. At December 31, 2005, 1,083,195 shares were available for purchase under the 2002 Employee Stock Purchase Plan (2002 Purchase Plan).

Prior to the plan change, the shareholders of the Company had approved the 2002 Purchase Plan, and reserved 5,000,000 shares of common stock for sale to employees at a price no less than 85% of the lower of the fair market value of the common stock at the beginning of the one-year offering period or the end of each of the six-month purchase periods. Under SFAS No. 123(R), the 2002 Purchase Plan was considered compensatory. As a result, the Company recorded \$0.4 million of compensation expense for the subscription period ended July 31, 2005.

401(k) Plan

The Company has a 401(k) salary deferral program for eligible employees who have met certain service requirements. The Company matches certain employee contributions; additional contributions to this plan are at the discretion of the Company. Total contribution expense under this plan was \$5.2 million for 2005, \$5.0 million for 2004 and \$8.7 million for 2003.

NOTE 22 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 NASD, which requires the maintenance of minimum net capital. The minimum net capital requirements can be met under either the Aggregate Indebtedness or the Alternative method. Under the Aggregate Indebtedness method, a broker-dealer is required to maintain minimum net capital of at least the greater of 6²/₃% of its aggregate indebtedness, as defined, or a minimum dollar amount. Under the Alternative method, a broker-dealer is required to maintain net capital of at least 5% of aggregate debit balances or a minimum dollar amount. Broker-dealers who do not meet one of these requirements may not repay subordinated borrowings, pay cash dividends or make any unsecured advances or loans to its parent or employees.

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

	December 31, 2005		
	Required Net Capital	Net Capital	Excess Net Capital
E*TRADE Clearing LLC ⁽¹⁾	\$ 57,914	\$ 345,957	\$ 288,043
BrownCo LLC ⁽¹⁾	67,292	309,576	242,284
E*TRADE Securities LLC ⁽¹⁾	250	33,720	33,470
E*TRADE Capital Markets, LLC	1,206	24,018	22,812
Harrisdirect LLC ⁽²⁾	250	19,376	19,126
E*TRADE Global Asset Management, Inc. ⁽²⁾	1,177	18,862	17,685
E*TRADE Capital Markets Execution Services, LLC ⁽²⁾	449	3,533	3,084
E*TRADE Professional Trading, LLC ⁽¹⁾	250	2,044	1,794
VERSUS Brokerage Service (U.S.) Inc. ⁽²⁾	100	797	697
International broker-dealers	28,871	68,452	39,581
Totals	\$ 157,759	\$ 826,335	\$ 668,576

(1) Elected to use the Alternative method to compute net capital.

(2) Elected to use the Aggregate Indebtedness method to compute net capital.

Banking

The Bank is subject to various regulatory capital requirements administered by Federal banking agencies. Failure to meet minimum capital requirements can trigger certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. 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.

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 table below, at December 31, 2005, 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 December 31, 2005, management believes that the Bank meets all capital adequacy requirements to which it is subject. However, events beyond management's control, such as fluctuations in interest rates or a downturn in the economy in areas in which the Bank's loans or securities are concentrated, could adversely affect future earnings and consequently, the Bank's ability to meet its future capital requirements.

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The Bank's required 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 December 31, 2005:						
Total Capital to risk-weighted assets	\$ 2,021,091	10.94%	>\$1,478,238	>8.0%	>\$ 1,847,797	>10.0%
Tier I Capital to risk-weighted assets	\$ 1,957,805	10.60%	>\$ 739,119	>4.0%	>\$ 1,108,678	> 6.0%
Tier I Capital to adjusted total assets	\$ 1,957,805	5.92%	>\$1,322,343	>4.0%	>\$ 1,652,929	> 5.0%
At December 31, 2004:						
Total Capital to risk-weighted assets	\$ 1,533,934	11.09%	>\$1,106,778	>8.0%	>\$ 1,383,472	>10.0%
Tier I Capital to risk-weighted assets	\$ 1,486,422	10.74%	>\$ 553,389	>4.0%	>\$ 830,083	> 6.0%
Tier I Capital to adjusted total assets	\$ 1,486,422	5.83%	>\$1,019,659	>4.0%	>\$ 1,274,574	> 5.0%

The Bank is also required by OTS regulations to maintain tangible capital of at least 1.50% of tangible assets. The Bank satisfied this requirement at both December 31, 2005 and 2004.

The Bank is subject to certain restrictions on the amount of dividends it may declare without prior regulatory approval. At December 31, 2005, the Bank has approximately \$192.5 million of capital available for dividend declaration without regulatory approval while still maintaining a well capitalized status.

NOTE 23 LEASE ARRANGEMENTS

The Company has non-cancelable operating leases for facilities through 2016. Future minimum rental commitments under these leases are as follows (in thousands):

Years ending December 31:	
2006	\$ 27,503
2007	26,872
2008	25,374
2009	22,397
2010	19,753
Thereafter	27,596
Total future minimum lease payments	\$ 149,495

Certain leases contain provisions for renewal options and rent escalations based on increases in certain costs incurred by the lessor. Rent expense was \$22.2 million for 2005, \$23.9 million for 2004 and \$31.4 million for 2003.

NOTE 24 COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS

Legal Matters

In June 2002, the Company acquired from MarketXT Holdings, Inc. (formerly known as Tradescape Corporation) (MarketXT) certain entities referred to as Tradescape Securities, LLC, Tradescape Technologies, LLC and Momentum Securities, LLC. Numerous disputes have arisen among the parties regarding the value of and responsibility for various liabilities that first became apparent following the sale. The parties have been unable to resolve these disputes and have asserted claims against each other. On April 8, 2004, MarketXT 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 MarketXT seeking declaratory relief and monetary damages in an amount to be proven at trial for defendants' fraud in connection with the 2002 sale transaction, including, but not limited to, having presented the Company with fraudulent financial statements of the condition of Momentum Securities during the due diligence process. The Company amended its complaint in October 2004 to add additional defendants. In January 2005, the Company filed an adversary proceeding against MarketXT and others seeking compensatory and punitive damages, and certain declaratory relief in those Chapter 11 bankruptcy proceedings in the United States Bankruptcy Court for the Southern District of New York entitled, *In re MarketXT Holdings Corp., Debtor* and a separate adversary proceeding against Omar Amanat, in the same bankruptcy court in those Chapter 7 bankruptcy proceedings entitled, *In re Amanat, Omar Shariff*. In October 2005, MarketXT answered the Company's adversary proceeding and asserted various counterclaims, including some of the claims MarketXT had asserted in its district court action (which action MarketXT subsequently abandoned), seeking unspecified damages according to proof at trial. The Company has moved to dismiss certain aspects of MarketXT's counterclaim, and discovery related to the adversary proceeding continues. The Company continues to believe that the claims brought against it by MarketXT and Omar Amanat are without merit and intends both to vigorously defend all such claims and to fully pursue its own claims as described above.

In September 2001, the Company engaged in certain stock loan transactions that resulted in litigation between the Company and certain counterparties to the transactions including Nomura Securities, Inc. and certain of its affiliates (Nomura). In the lawsuits, Nomura sought approximately \$10.0 million in damages and asserted the right to keep an additional \$5.0 million, plus interest, unspecified punitive damages, attorney fees, and other relief from the Company for conversion and breach of contract. The Company asserted claims and defenses against Nomura relating to the same amount and alleged, *inter alia*, that Nomura, among others, participated in a stock lending fraud and violated federal and state securities laws among other allegations. The Company sought, among other things, compensatory damages for all expenses and losses that it had incurred to date. On December 5, 2005, the Company entered into an agreement with Nomura and its subsidiaries and affiliates to settle the lawsuits pending between the parties in New York and Minnesota. Pursuant to that agreement, Nomura, without admission of liability, agreed to pay, and has paid, \$35.0 million to the Company to resolve these disputes; the Company and Nomura further agreed to dismiss their claims against each other. With the resolution of these matters, this litigation will no longer be included in our disclosures.

An unfavorable outcome in any matter that is not covered by insurance could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, even if the ultimate outcomes are resolved in our favor, the defense of such litigation could entail considerable cost and the diversion of the efforts of management, either of which could have a material adverse effect on our results of operation. 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. The Company contests liability and/or the amount of damages in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss related to such matters, how such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief might be. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of each such pending matter will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome could be material to the Company's or a business segment's operating results for a particular future period, depending on, among other things, the level of the Company's or a business segment's income for such period. Legal reserves have been established in accordance with SFAS No. 5. Once established, reserves are adjusted when there is more information available or when an event occurs requiring a change.

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 qualified 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. The regulators may also initiate investigations and take disciplinary action against the Company or its employees. Any such claims or disciplinary actions that are decided against the Company could have a material impact on the financial results of the Company or any of its subsidiaries.

Insurance Matters

The Company maintains insurance coverage that management believes is reasonable and prudent. The principal insurance coverage it maintains covers commercial general liability, property damage, hardware/software damage, cyber liability, directors and officers, employment practices liability, certain criminal acts against the Company and errors and omissions. The Company believes that such insurance coverage is adequate for the purpose of its business. The Company's ability to maintain this level of insurance coverage in the future, however, is subject to the availability of affordable insurance in the marketplace.

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 mortgage loan commitments (in thousands):

	December 31, 2005		
	Fixed		
	Rate	Variable Rate	Total
Purchase loans	\$ 316,040	\$ 46,163	\$ 362,203
Originate loans	\$ 94,512	\$ 17,940	\$ 112,452
Sell loans	\$ 24,294	\$ 10,793	\$ 35,087

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

At December 31, 2005, the Bank had commitments to purchase \$0.9 billion and sell \$1.0 billion in securities. In addition, the Bank had approximately \$2.3 billion of certificates of deposit scheduled to mature in less than one year and \$6.2 billion of unfunded commitments to extend credit.

Guarantees

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

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 its terms. The mortgage has been duly acknowledged and recorded and is valid. 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

claims prove to be untrue, the investor can require the Bank to repurchase the loan and return all loan purchase and servicing release premiums.

Should any eligible mortgage loan delivered pay off prior to the receipt of the first payment, the loan purchase and servicing release premiums shall be fully refunded.

Should any eligible mortgage loan delivered to an investor pay off between the receipt of the first payment and a contractually designated period of time (typically 60 120 days from the date of purchase), the servicing release premiums shall be fully refunded.

Management has determined that the maximum potential liability under these guarantees is \$18.3 million and \$38.1 million based on all available information at December 31, 2005 and December 31, 2004, respectively. The current carrying amount of the liability recorded at December 31, 2005 is \$0.4 million and is considered adequate based upon analysis of historical trends and current economic conditions for these guarantees.

During the 30-year period prior to the redemption of the Floating Rate Cumulative Preferred 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 December 31, 2005, management estimated that the maximum potential liability under this arrangement is equal to approximately \$312 million or the total face value of these securities plus dividends, which may be unpaid at the termination of the trust arrangement.

NOTE 25 SEGMENT AND GEOGRAPHIC INFORMATION

In January 2005, the Company revised its financial reporting to reflect the manner in which its chief operating decision maker has begun assessing the Company's performance and makes resource allocation decisions. As a result, the Company now reports its operating results in two segments, retail and institutional, rather than its former brokerage and banking segments.

Retail includes:

investing, trading, cash management and lending products and services to individuals; and

stock plan administration products and services activity

Institutional includes:

balance sheet management, including generation of institutional net interest spread, gain on sales of loans and securities, net and management income;

market-making; and

global execution and settlement services

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

	Year Ended December 31, 2005			
	Retail	Institutional	Eliminations⁽¹⁾	Total
Revenues:				
Commissions	\$ 339,654	\$ 119,180	\$	\$ 458,834
Principal transactions		99,175	161	99,336
Gain on sales of loans and securities, net	63,705	35,153		98,858
Service charges and fees	116,102	19,212		135,314
Other revenues	112,836	10,383	(28,800)	94,419
Interest income	685,067	1,395,769	(430,572)	1,650,264
Interest expense	(239,943)	(969,631)	430,410	(779,164)
Net interest income	445,124	426,138	(162)	871,100
Provision for loan losses		(54,016)		(54,016)
Net interest income after provision for loan losses	445,124	372,122	(162)	817,084
Total revenues	1,077,421	655,225	(28,801)	1,703,845
Expense excluding interest:				
Compensation and benefits	232,494	148,309		380,803
Occupancy and equipment	57,869	11,220		69,089
Communications	71,693	10,792		82,485
Professional services	55,081	20,156		75,237
Commissions, clearance and floor brokerage	42,715	106,347	(8,256)	140,806
Advertising and market development	96,918	9,017		105,935
Servicing and other banking expenses	6,166	66,705	(20,545)	52,326
Fair value adjustments of financial derivatives		4,892		4,892
Depreciation and amortization	60,604	14,377		74,981
Amortization of other intangibles	13,894	29,871		43,765
Facility restructuring and other exit activities	(32,754)	2,737		(30,017)
Other	13,984	39,767		53,751
Total expenses excluding interest	618,664	464,190	(28,801)	1,054,053
Segment income	\$ 458,757	\$ 191,035	\$	\$ 649,792

(1) Reflects elimination of transactions between retail and institutional segments, which includes deposit transfer pricing, servicing and order flow rebates.

	Year Ended December 31, 2004			
	Retail	Institutional	Eliminations ⁽¹⁾	Total
Revenues:				
Commissions	\$ 328,889	\$ 102,749	\$	\$ 431,638
Principal transactions		126,893		126,893
Gain on sales of loans and securities, net	93,694	47,024		140,718
Service charges and fees	84,445	13,130		97,575
Other revenues	106,457	16,684	(34,064)	89,077
Interest income	492,233	956,972	(303,608)	1,145,597
Interest expense	(169,955)	(644,108)	303,608	(510,455)
Net interest income	322,278	312,864		635,142
Provision for loan losses		(38,121)		(38,121)
Net interest income after provision for loan losses	322,278	274,743		597,021
Total revenues	935,763	581,223	(34,064)	1,482,922
Expense excluding interest:				
Compensation and benefits	227,867	122,573		350,440
Occupancy and equipment	57,437	12,135		69,572
Communications	61,112	8,562		69,674
Professional services	43,470	24,277		67,747
Commissions, clearance and floor brokerage	42,227	100,205	(12,736)	129,696
Advertising and market development	57,193	4,962		62,155
Servicing and other banking expenses	7,754	49,545	(21,328)	35,971
Fair value adjustments of financial derivatives		(2,299)		(2,299)
Depreciation and amortization	65,599	12,293		77,892
Amortization of other intangibles	11,863	7,580		19,443
Facility restructuring and other exit activities	4,784	10,904		15,688
Other	48,840	42,304		91,144
Total expenses excluding interest	628,146	393,041	(34,064)	987,123
Segment income	\$ 307,617	\$ 188,182	\$	\$ 495,799

(1) Reflects elimination of transactions between retail and institutional segments, which includes deposit transfer pricing, servicing and order flow rebates.

	Year Ended December 31, 2003			Total
	Retail	Institutional	Eliminations ⁽¹⁾	
Revenues:				
Commissions	\$ 316,092	\$ 106,617	\$	\$ 422,709
Principal transactions		107,601		107,601
Gain on sales of loans and securities, net	235,064	12,590		247,654
Service charges and fees	104,531	5,527		110,058
Other revenues	104,157	24,737	(42,380)	86,514
Interest income	353,483	748,819	(209,470)	892,832
Interest expense	(219,513)	(476,086)	209,470	(486,129)
Net interest income	133,970	272,733		406,703
Provision for loan losses		(38,523)		(38,523)
Net interest income after provision for loan losses	133,970	234,210		368,180
Total revenues	893,814	491,282	(42,380)	1,342,716
Expense excluding interest:				
Compensation and benefits	256,982	107,616		364,598
Occupancy and equipment	63,502	14,879		78,381
Communications	63,645	10,005		73,650
Professional services	38,827	16,889		55,716
Commissions, clearance and floor brokerage	33,100	104,689	(12,921)	124,868
Advertising and market development	55,011	2,876		57,887
Servicing and other banking expenses	29,518	37,516	(29,459)	37,575
Fair value adjustments of financial derivatives		15,338		15,338
Depreciation and amortization	72,531	13,084		85,615
Amortization of other intangibles	16,530	8,228		24,758
Facility restructuring and other exit activities	83,864	50,323		134,187
Other	55,808	45,234		101,042
Total expenses excluding interest	769,318	426,677	(42,380)	1,153,615
Segment income	\$ 124,496	\$ 64,605	\$	\$ 189,101

(1) Reflects elimination of transactions between retail and institutional segments, which includes deposit transfer pricing, servicing and order flow rebates.

Total assets for each segment are shown below (in thousands):

	Retail	Institutional	Total
At December 31, 2005	\$ 12,901,008	\$ 31,666,678	\$ 44,567,686
At December 31, 2004	\$ 5,294,487	\$ 25,738,096	\$ 31,032,583

Geographic Information

The Company operates in both U.S. and international markets. The Company's international operations are conducted through offices in Europe, Asia and Canada. The following information provides a reasonable representation of each region's contribution to the consolidated amounts (in thousands):

	<u>United States</u>	<u>Europe</u>	<u>Asia</u>	<u>Canada</u>	<u>Total</u>
Net revenues:					
Year ended December 31, 2005	\$ 1,496,204	\$ 80,505	\$ 71,683	\$ 55,453	\$ 1,703,845
Year ended December 31, 2004	\$ 1,310,234	\$ 89,979	\$ 32,360	\$ 50,349	\$ 1,482,922
Year ended December 31, 2003	\$ 1,220,774	\$ 67,815	\$ 10,384	\$ 43,743	\$ 1,342,716
Long-lived assets:					
At December 31, 2005	\$ 285,870	\$ 5,047	\$ 1,254	\$ 7,085	\$ 299,256
At December 31, 2004	\$ 286,183	\$ 7,699	\$ 728	\$ 7,681	\$ 302,291

No single customer accounted for greater than 10% of gross revenues for 2005, 2004 and 2003.

NOTE 26 FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments whose estimated fair values were their carrying values are summarized as follows:

Cash and equivalents, cash and investments required to be segregated, brokerage receivables, net and brokerage payables Fair value is estimated to be carrying value.

Available-for-sale investment securities including mortgage-backed, trading securities and other investments Fair value is estimated by using quoted market prices for most securities. For illiquid securities, market prices are estimated by obtaining market price quotes on similar liquid securities and adjusting the price to reflect differences between the two securities, such as credit risk, liquidity, term coupon, payment characteristics and other information.

FHLB stock Cost is considered to be a reasonable estimate of fair value because the FHLB has historically redeemed these securities at cost.

Financial derivatives and off-balance instruments The fair value of financial derivatives and off-balance sheet instruments is the amount the Company would pay or receive to terminate the agreement as determined from quoted market prices, which is equal to the carrying value.

Commitments to purchase and originate loans The fair value is estimated by calculating the net present value of the anticipated cash flows associated with IRLCs.

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The fair value of financial instruments whose estimated fair values were different from their carrying values are summarized below (in thousands):

	December 31, 2005		December 31, 2004	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Loans receivable, net and loans held-for-sale, net	\$ 19,512,266	\$ 19,242,275	\$ 11,785,035	\$ 11,765,901
Liabilities:				
Deposits	\$ 15,948,015	\$ 15,937,684	\$ 12,302,974	\$ 12,359,634
Securities sold under agreements to repurchase	\$ 11,101,542	\$ 11,014,478	\$ 9,897,191	\$ 9,894,611
Other borrowings by Bank subsidiary	\$ 4,166,592	\$ 4,091,755	\$ 1,760,732	\$ 1,745,850
Senior notes	\$ 1,401,947	\$ 1,437,132	\$ 400,452	\$ 428,452
Mandatory convertible notes	\$ 435,589	\$ 493,958		
Convertible subordinated notes	\$ 185,165	\$ 187,942	\$ 185,165	\$ 189,794

Loans receivable, net and loans held-for-sale, net For certain residential mortgage loans, fair value is estimated using quoted market prices for similar types of products. The fair value of certain other types of loans is estimated using quoted market prices for securities backed by similar loans. The fair value for loans that could not be reasonably established using the previous two methods was estimated by discounting future cash flows using current rates for similar loans. Management adjusts the discount rate to reflect the individual characteristics of the loan, such as credit risk, coupon, term, payment characteristics and the liquidity of the secondary market for these types of loans. The fair value for certain consumer loans was calculated using a discounted cash flow model incorporating prepayment and loss curves for the specific product type. Loans were valued in groups based on rate and term with the discount rate applied to each group derived from the swap curve. The calculation of loss and prepayment curves was based on past performance of similar credit quality originations by the same counterparty.

Deposits For SDA, money market, passbook savings and checking accounts, fair value is estimated to be carrying value. For fixed maturity certificates of deposit, fair value is estimated by discounting future cash flows at the currently offered rates for deposits of similar remaining maturities.

Securities sold under agreements to repurchase Fair value is determined by discounting future cash flows at the rate implied for other similar instruments with similar remaining maturities.

Other borrowings by Bank subsidiary For adjustable-rate borrowings, fair value is estimated to be carrying value. For fixed-rate borrowings, fair value is estimated by discounting future cash flows at the currently offered rates for fixed-rate borrowings of similar remaining maturities.

Senior, mandatory convertible and convertible subordinated notes Fair value is estimated using quoted market prices.

NOTE 27 RELATED PARTY TRANSACTIONS

In the normal course of business, the Company extends credit to its principal officers, directors and employees to finance their purchases of securities on margin. Margin loans to the Company's principal officers totaled approximately \$5.3 million at December 31, 2005 and \$6.6 million as of December 31, 2004; however, there were revolving margin balances outstanding during 2005 and 2004 with certain directors. These margin loans are made on the same terms and conditions as the Company's loans to other non-affiliated customers.

NOTE 28 CONDENSED FINANCIAL INFORMATION (PARENT COMPANY ONLY)

The following presents the Parent's condensed balance sheets, statements of income and cash flows:

BALANCE SHEETS**(in thousands)**

	December 31,	
	2005	2004
<u>ASSETS</u>		
Cash and equivalents	\$ 93,514	\$ 69,007
Property and equipment, net	205,796	199,706
Investment securities	48,246	49,530
Investment in Bank subsidiary	1,551,024	1,246,259
Investment in other consolidated subsidiaries	3,566,531	1,402,645
Receivable from subsidiaries	116,100	3,382
Other assets	49,074	41,709
Total assets	\$ 5,630,285	\$ 3,012,238
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Senior notes	\$ 1,401,947	\$ 400,452
Mandatory convertible notes	435,589	
Convertible subordinated notes	185,165	185,165
Other liabilities	208,024	198,419
Shareholders' equity	3,399,560	2,228,202
Total liabilities and shareholders' equity	\$ 5,630,285	\$ 3,012,238

STATEMENTS OF INCOME

(in thousands)

	Year Ended December 31,		
	2005	2004	2003
Revenues:			
Management fees from subsidiaries	\$ 224,894	\$ 318,772	\$ 312,947
Net revenues	224,894	318,772	312,947
Expenses excluding interest:			
Compensation and benefits	130,081	124,208	107,391
Occupancy and equipment	25,036	32,335	29,543
Communications	18,973	17,949	19,090
Depreciation and amortization	50,528	54,664	57,776
Professional services	27,647	30,445	22,563
Commissions, clearance and floor brokerage	206	(1,062)	2,347
Advertising and market development	13,498	6,154	3,308
Facility restructuring and other exit activities	2,991	14,478	115,412
Intercompany allocations and charges	(120,598)	(30,260)	3,529
Other	17,545	33,089	23,879
Total expenses excluding interest	165,907	282,000	384,838
Income (loss) before other loss, income taxes and cumulative effect of accounting change	58,987	36,772	(71,891)
Other loss:			
Corporate interest income	2,265	740	1,445
Corporate interest expense	(71,510)	(45,775)	(44,468)
Gain on sale and impairment of investments	982	1,427	16,175
Loss on early extinguishment of debt		(19,443)	
Equity in income of investment and venture funds	6,247	4,858	9,051
Total other loss	(62,016)	(58,193)	(17,797)
Pre-tax loss	(3,029)	(21,421)	(89,688)
Income tax benefit	(10,806)	(42,007)	(57,821)
Income (loss) before cumulative effect of accounting change	7,777	20,586	(31,867)
Cumulative effect of accounting change	1,646		
Equity in income of Bank subsidiary	284,987	215,614	133,632
Equity in income of other consolidated subsidiaries	136,002	144,283	101,262
Net income	430,412	380,483	203,027
Other comprehensive income (loss), net of tax	(34,513)	(51,222)	141,480
Total comprehensive income	\$ 395,899	\$ 329,261	\$ 344,507

STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 430,412	\$ 380,483	\$ 203,027
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed income of Bank subsidiary	(284,987)	(215,614)	(133,632)
Equity in undistributed loss (income) of other subsidiaries	229,777	(100,771)	(51,262)
Equity in net income of investments	(6,475)	(10,272)	(14,584)
Depreciation and amortization	50,528	54,664	57,668
Stock-based compensation expense	6,916		
Gain on investments and impairment charges	(946)	(1,427)	(93)
Unrealized loss on venture fund	228	5,412	4,103
Non cash restructuring costs and other exit activities	2,991	14,478	30,770
Cumulative effect of accounting change	(1,646)		
Other	1,459	4,645	(1,348)
Other changes, net:			
Other assets and liabilities, net	(83,483)	77,771	(45,877)
Decrease in restructuring liabilities	(4,581)	(9,299)	(27,389)
Net cash provided by operating activities	340,193	200,070	21,383
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(66,191)	(70,206)	(38,344)
Purchase of investments	(9,785)	(10,566)	(5,800)
Proceeds from sale/maturity of investments	18,803	16,409	4,246
Business acquisitions	(2,312,879)		
Cash contribution to subsidiaries	(80,000)		(68,153)
Other	1,021		(1,471)
Net cash used in investing activities	(2,449,031)	(64,363)	(109,522)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from sale of investments			4,946
Proceeds from issuance of common stock	753,134	43,974	51,740
Tax benefit on option exercises	10,352	17,913	13,186
Proceeds from issuance of senior notes	992,064	394,000	
Proceeds from issuance of Units	436,500		
Repurchase of treasury stock	(58,215)	(175,776)	
Redemption of subordinated notes		(428,902)	
Payment of capital leases	(157)	(734)	(6,031)
Other	(333)	260	9,123
Net cash provided by (used in) financing activities	2,133,345	(149,265)	72,964
INCREASE (DECREASE) IN CASH AND EQUIVALENTS	24,507	(13,558)	(15,175)
CASH AND EQUIVALENTS Beginning of year	69,007	82,565	97,740
CASH AND EQUIVALENTS End of year	\$ 93,514	\$ 69,007	\$ 82,565



Parent Company Guarantees

Guarantees are contingent commitments issued by the Company for the purpose of guaranteeing the financial obligations of a subsidiary to a financial institution. The collective obligation of the corporation does not change by the existence of corporate guarantees. Rather, the guarantees shift ultimate payment responsibility of an existing financial obligation from a subsidiary to the parent company.

In support of the Company's brokerage business, the Company has provided guarantees on the settlement of its subsidiaries' financial obligations with several financial institutions related to its securities lending activities. Terms and conditions of the guarantees, although typically undefined in the guarantees themselves, are governed by the conditions of the underlying obligation that the guarantee covers. Thus, the Company's obligation to pay under these guarantees coincides exactly with the terms and conditions of those underlying obligations. At December 31, 2005, no claims had been filed with the Company for payment under any guarantees. These guarantees are not collateralized.

In addition to guarantees issued on behalf of subsidiaries participating in securities lending programs, the Company also issues guarantees for the settlement of foreign exchange transactions. If a subsidiary fails to deliver currency on the settlement date of a foreign exchange arrangement, the beneficiary financial institution may seek payment from the Company. Terms are undefined, and are governed by the terms of the underlying financial obligation. At December 31, 2005, no claims had been made on the Company under these guarantees and thus, no obligations had been recorded. These guarantees are not collateralized.

NOTE 29 SUBSEQUENT EVENTS

On February 17, 2006, the Company signed an agreement to sell its professional agency business, E*TRADE Professional Trading, LLC for approximately \$5.0 million. This business includes a broker-dealer registered with the SEC and a member of the NASD who currently executes and clears its customer security transactions through E*TRADE Clearing LLC, on a fully disclosed basis under an introducing broker-dealer relationship.

NOTE 30 QUARTERLY DATA (UNAUDITED)

The information presented below reflects all adjustments, which, in the opinion of management, are of a normal and recurring nature necessary to present fairly the results of operations for the periods presented (in thousands, except per share amounts):

	2005				2004			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter
Net revenues	\$ 417,397	\$ 387,687	\$ 419,836	\$ 478,925	\$ 374,662	\$ 374,465	\$ 330,122	\$ 403,673
Income from continuing operations	\$ 102,206	\$ 109,383	\$ 109,138	\$ 125,511	\$ 91,045	\$ 103,204	\$ 88,103	\$ 99,478
Net income	\$ 91,994	\$ 101,567	\$ 107,491	\$ 129,360	\$ 88,475	\$ 122,905	\$ 79,274	\$ 89,829
Income per share from continuing operations:								
Basic	\$ 0.28	\$ 0.30	\$ 0.30	\$ 0.32	\$ 0.25	\$ 0.28	\$ 0.24	\$ 0.26
Diluted	\$ 0.27	\$ 0.29	\$ 0.29	\$ 0.31	\$ 0.23	\$ 0.27	\$ 0.23	\$ 0.26

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Income per share:																
Basic	\$	0.25	\$	0.28	\$	0.29	\$	0.33	\$	0.24	\$	0.34	\$	0.21	\$	0.24
Diluted	\$	0.24	\$	0.27	\$	0.28	\$	0.32	\$	0.23	\$	0.31	\$	0.21	\$	0.24

Item 15. Exhibits

- 23.1 Consent of Independent Registered Public Accounting Firm
- 31.1 Certification Section 302 of the Sarbanes-Oxley
- 31.2 Certification Section 302 of the Sarbanes-Oxley
- 32.1 Certification Section 906 of the Sarbanes-Oxley