

FREMONT GENERAL CORP

Form 10-Q

November 09, 2007

Table of Contents

United States Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

(Mark One)

Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended September 30, 2007

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 001-08007

Fremont General Corporation

(Exact Name of Registrant as Specified in its Charter)

Nevada

(State or other jurisdiction of incorporation or organization)

95-2815260

(I.R.S. Employer Identification No.)

2425 Olympic Boulevard

Santa Monica, California 90404

(Address of principal executive offices) (Zip Code)

(310) 315-5500

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name or Former Address, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required 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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock:

| Class | Shares Outstanding October 31, 2007 |
|--------------------------------|--|
| Common Stock, \$1.00 par value | 79,630,085 |

Fremont General Corporation and Subsidiaries

INDEX

| | Page No. |
|---|----------------|
| PART I FINANCIAL INFORMATION | |
| <u>Item 1.</u> | 1 |
| <u>Financial Statements</u> | |
| <u>Consolidated Balance Sheets</u> | |
| <u>September 30, 2007 (Unaudited) and December 31, 2006</u> | 1 |
| <u>Consolidated Statements of Operations</u> | |
| <u>Three and Nine Months Ended September 30, 2007 and 2006 (Unaudited)</u> | 2 |
| <u>Consolidated Statements of Changes in Stockholders' Equity</u> | |
| <u>September 30, 2007 and 2006 (Unaudited)</u> | 3 |
| <u>Consolidated Statements of Cash Flows</u> | |
| <u>Nine Months Ended September 30, 2007 and 2006 (Unaudited)</u> | 4 |
| <u>Consolidated Statements of Comprehensive Income (Loss)</u> | |
| <u>Three and Nine Months Ended September 30, 2007 and 2006 (Unaudited)</u> | 5 |
| <u>Notes to Consolidated Financial Statements (Unaudited)</u> | 6 |
| <u>Item 2.</u> | 27 |
| <u>Management's Discussion and Analysis of Financial Condition and Results of</u> | |
| <u>Operations</u> | |
| <u>Item 3.</u> | 37 |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u> | |
| <u>Item 4.</u> | 38 |
| <u>Controls and Procedures</u> | |
| PART II OTHER INFORMATION | |
| <u>Item 1.</u> | 39 |
| <u>Legal Proceedings</u> | |
| <u>Item 1A.</u> | 39 |
| <u>Risk Factors</u> | |
| <u>Item 2.</u> | 39 |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | |
| Item 3 5. | Not applicable |
| <u>Item 6.</u> | 40 |
| <u>Exhibits</u> | |
| <u>Signatures</u> | S-1 |
| <u>EXHIBIT 31.1</u> | |
| <u>EXHIBIT 31.2</u> | |
| <u>EXHIBIT 32.1</u> | |

Table of ContentsItem 1. *Financial Statements***Fremont General Corporation and Subsidiaries
Consolidated Balance Sheets**

| (Thousands of dollars, except share data) | September 30, 2007 | December 31, 2006 |
|--|-----------------------|----------------------|
| | (Unaudited) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 2,658,068 | \$ 761,642 |
| Investment securities classified as available-for-sale at fair value | 1,175,858 | 633 |
| Federal Home Loan Bank stock at cost | 25,925 | 111,860 |
| Loans held for investment net | 2,116 | 6,257,306 |
| Commercial real estate participation | 3,624,260 | |
| Accrued interest receivable | 32,231 | 53,497 |
| Real estate owned net | | 299 |
| Premises and equipment net | 24,647 | 67,859 |
| Deferred income taxes net | | 52,576 |
| Other assets | 341,137 | 268,932 |
| Assets of discontinued operations held for sale | 906,825 | 5,315,920 |
| TOTAL ASSETS | \$ 8,791,067 | \$ 12,890,524 |
| LIABILITIES | | |
| Deposits: | | |
| Savings accounts | \$ 954,686 | \$ 1,101,137 |
| Money market deposit accounts | 419,815 | 586,158 |
| Certificates of deposit | 6,586,025 | 8,302,493 |
| | 7,960,526 | 9,989,788 |
| Senior Notes due 2009 | 166,111 | 165,895 |
| Junior Subordinated Debentures | 103,093 | 103,093 |
| Other liabilities | 141,929 | 210,586 |
| Liabilities of discontinued operations held for sale | 114,450 | 1,307,205 |
| TOTAL LIABILITIES | 8,486,109 | 11,776,567 |
| Commitments and contingencies | | |
| STOCKHOLDERS EQUITY | | |
| Preferred stock, par value \$.01 per share Authorized: 2,000,000 shares; none issued | 78,117 | 75,983 |

Edgar Filing: FREMONT GENERAL CORP - Form 10-Q

| | | | |
|---|--|---------------------|---------------|
| Common stock, par value \$1 per share | Authorized: 150,000,000 shares; issued | | |
| and outstanding: (2007 | 79,630,000 and 2006 | 79,074,000) | |
| Additional paid-in capital | | 344,535 | 324,064 |
| Retained earnings | | (112,023) | 728,766 |
| Deferred compensation | | (8,005) | (20,694) |
| Accumulated other comprehensive income | | 2,334 | 5,838 |
| | | | |
| TOTAL STOCKHOLDERS EQUITY | | 304,958 | 1,113,957 |
| | | | |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | | \$ 8,791,067 | \$ 12,890,524 |

The accompanying notes are an integral part of these statements.

2007 QUARTERLY REPORT 1

Table of Contents**Fremont General Corporation and Subsidiaries
Consolidated Statements of Operations (Unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|---------------|------------------------------------|---------------|
| (Thousands of dollars, except per share data) | 2007 | 2006 | 2007 | 2006 |
| INTEREST INCOME: | | | | |
| Interest and fee income on loans: | | | | |
| Commercial | \$ 1,444 | \$ 144,305 | \$ 292,688 | \$ 380,365 |
| Other | 129 | | 321 | 1 |
| | 1,573 | 144,305 | 293,009 | 380,366 |
| Interest income other | 128,601 | 8,883 | 169,133 | 22,837 |
| | 130,174 | 153,188 | 462,142 | 403,203 |
| INTEREST EXPENSE: | | | | |
| Deposits | 99,442 | 56,747 | 277,448 | 140,401 |
| Senior Notes | 3,351 | 3,388 | 10,051 | 10,398 |
| Junior Subordinated Debentures | 2,319 | 2,320 | 6,958 | 6,959 |
| | 105,112 | 62,455 | 294,457 | 157,758 |
| Net interest income | 25,062 | 90,733 | 167,685 | 245,445 |
| Provision for loan losses | 151 | 12,687 | 333 | 28,288 |
| | 24,911 | 78,046 | 167,352 | 217,157 |
| NON-INTEREST INCOME: | | | | |
| Gain on sale of commercial real estate loans | 16,289 | | 16,289 | |
| Other non-interest income | 49,600 | 4,825 | 51,056 | 11,129 |
| | 65,889 | 4,825 | 67,345 | 11,129 |
| NON-INTEREST EXPENSE: | | | | |
| Compensation and related | 14,356 | 25,134 | 88,813 | 77,535 |
| Occupancy | 3,060 | 3,279 | 12,945 | 10,128 |
| Other | 19,450 | 19,591 | 76,141 | 49,116 |
| | 36,866 | 48,004 | 177,899 | 136,779 |
| INCOME BEFORE INCOME TAXES | 53,934 | 34,867 | 56,798 | 91,507 |
| Income tax expense | 21,738 | 12,190 | 24,518 | 34,797 |

| | | | | |
|---|------------------|-----------|---------------------|------------|
| Income from continuing operations | 32,196 | 22,677 | 32,280 | 56,710 |
| Income (loss) from discontinued operations, net of income taxes of \$(9,480) and \$4,986, and \$(92,356) and \$38,101 for the three and nine months ended September 30, 2007 and 2006, respectively | (13,895) | 6,848 | (869,773) | 56,426 |
| Net income (loss) | \$ 18,301 | \$ 29,525 | \$ (837,493) | \$ 113,136 |
| EARNINGS PER SHARE: | | | | |
| Basic: | | | | |
| Income from continuing operations | \$ 0.42 | \$ 0.31 | \$ 0.42 | \$ 0.77 |
| Income (loss) from discontinued operations, net of income taxes | (0.18) | 0.09 | (11.39) | 0.76 |
| Net income (loss) | \$ 0.24 | \$ 0.40 | \$ (10.97) | \$ 1.53 |
| Diluted: | | | | |
| Income from continuing operations | \$ 0.41 | \$ 0.30 | \$ 0.42 | \$ 0.75 |
| Income (loss) from discontinued operations, net of income taxes | (0.18) | 0.09 | (11.25) | 0.74 |
| Net income (loss) | \$ 0.23 | \$ 0.39 | \$ (10.83) | \$ 1.49 |
| CASH DIVIDENDS DECLARED PER COMMON SHARE | \$ | \$ 0.11 | \$ | \$ 0.33 |

The accompanying notes are an integral part of these statements.

2 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents**Fremont General Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity (Unaudited)**

| Thousands, except per share amounts) | Common Stock | | Additional Paid-in Capital | Retained Earnings | Deferred Compensation | Accumulated | | Total |
|--|---------------------------------------|-----------|----------------------------------|----------------------|--------------------------|----------------------------------|--------------|-------|
| | Number of Outstanding Shares | Amount | | | | Other Comprehensive Income | | |
| Balance at December 31, 2005 | 77,497 | \$ 77,497 | \$ 341,800 | \$ 966,112 | \$ (43,357) | \$ 14,754 | \$ 1,356,806 | |
| Net income | | | | 113,136 | | | 113,136 | |
| Dividends declared \$0.33 per share | | | | (25,621) | | | (25,621) | |
| Classification of deferred compensation as restricted stock | | (1,485) | (19,417) | | 20,902 | | | |
| Reversal of common stock | (41) | | | | | | | |
| Shares issued, acquired or allocated for employee benefit plans | 406 | | (1,673) | | (23,036) | | (24,713) | |
| Amortization of restricted stock | | | 11,074 | | | | 11,074 | |
| Shares allocated to ESOP | | | (1,370) | | 24,315 | | 22,945 | |
| Increase in cost of common stock held in treasury | | | | | (1,718) | | (1,718) | |
| Change in unrealized gain on investments and residual interests, net of deferred taxes | | | | | | 2,405 | 2,405 | |
| Less tax benefits relating to share-based payments | | | 2,050 | | | | 2,050 | |
| ESOP fair value adjustment | | | (755) | | 755 | | | |
| Balance at September 30, 2006 | 77,862 | \$ 76,012 | \$ 331,709 | \$ 1,053,627 | \$ (22,139) | \$ 17,159 | \$ 1,456,368 | |
| Balance at December 31, 2006 | 79,074 | \$ 75,983 | \$ 324,064 | \$ 728,766 | \$ (20,694) | \$ 5,838 | \$ 1,113,933 | |
| Net loss | | | | (837,493) | | | (837,493) | |
| Dividends adjustment | | | | 93 | | | 93 | |
| Adoption of FIN No. 48 | | | | (3,389) | | | (3,389) | |
| Reversal of common stock | (1,088) | | | | | | | |
| Restricted stock vested | | 849 | 13,937 | | | | 14,786 | |
| Shares issued, acquired or allocated for employee benefit plans | 359 | | (2,920) | | (5,187) | | (8,107) | |
| Amortization of restricted stock | | | 4,361 | | | | 4,361 | |
| Shares allocated to ESOP | 1,285 | 1,285 | 8,249 | | 3,334 | | 12,868 | |
| Increase in cost of common stock held in treasury | | | | | | 11,386 | 11,386 | |
| Change in unrealized gain on investments and residual interests, net of deferred taxes | | | | | | | | |
| Less tax benefits relating to share-based payments | | | | | | (3,504) | (3,504) | |
| ESOP fair value adjustment | | | (3,156) | | 3,156 | | | |

nce at September 30, 2007 **79,630** \$ **78,117** \$ **344,535** \$ **(112,023)** \$ **(8,005)** \$ **2,334** \$ **304,9**

The accompanying notes are an integral part of these statements.

2007 QUARTERLY REPORT 3

Table of Contents**Fremont General Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)**

| | Nine Months Ended September 30, | |
|--|------------------------------------|-------------|
| (Thousands of dollars) | 2007 | 2006 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | \$ (837,493) | \$ 113,136 |
| Less: income (loss) from discontinued operations | (869,773) | 56,426 |
| Income from continuing operations | 32,280 | 56,710 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | |
| Provision for loan losses | 333 | 28,288 |
| Provision for deferred income taxes | 14,267 | 6,669 |
| Depreciation and amortization | 16,227 | 11,898 |
| Compensation expense related to deferred compensation plans | 273 | 4,872 |
| Change in accrued interest | 34,720 | (28,711) |
| Change in other assets | (226,924) | (34,043) |
| Change in accounts payable and other liabilities | (110,375) | (31,392) |
| Originations and advances funded for commercial real estate loans held for sale | (1,664,535) | |
| Payments received from and sales of commercial real estate loans held for sale | 3,731,306 | |
| NET CASH PROVIDED BY OPERATING ACTIVITIES CONTINUING OPERATIONS | 1,827,572 | 14,291 |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES DISCONTINUED OPERATIONS | 3,626,653 | (114,595) |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | 5,454,225 | (100,304) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Originations of loans held for investment | | (3,068,122) |
| Payments received from and sales of loans held for investment | | 1,711,609 |
| Investment securities available for sale: | | |
| Purchases | (1,307,516) | (4,352) |
| Maturities or repayments | 132,187 | 210 |
| Net purchases of FHLB stock | 85,935 | (12,972) |
| Payments received from commercial real estate participation | 576,948 | |
| Purchases of premises and equipment | (5,126) | (16,064) |
| NET CASH USED IN INVESTING ACTIVITIES CONTINUING OPERATIONS | (517,572) | (1,389,691) |
| | 72,634 | 75,987 |

NET CASH PROVIDED BY INVESTING ACTIVITIES DISCONTINUED
OPERATIONS

| | | |
|--|---------------------|-------------|
| NET CASH USED IN INVESTING ACTIVITIES | (444,938) | (1,313,704) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Deposits accepted, net of repayments | (2,029,262) | 957,499 |
| Extinguishment of Senior Notes | | (9,636) |
| Dividends paid | (9,489) | (24,806) |
| Excess tax benefits related to share-based payments | | 2,050 |
| Purchase of Company common stock for deferred compensation plans | (14,110) | (40,601) |
| | | |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES CONTINUING OPERATIONS | (2,052,861) | 884,506 |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES DISCONTINUED OPERATIONS | (1,060,000) | 281,000 |
| | | |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | (3,112,861) | 1,165,506 |
| Increase (decrease) in cash and cash equivalents | 1,896,426 | (248,502) |
| Cash and cash equivalents at beginning of period | 761,642 | 768,643 |
| | | |
| Cash and cash equivalents at end of period | \$ 2,658,068 | \$ 520,141 |

The accompanying notes are an integral part of these statements.

4 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents**Fremont General Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss) (Unaudited)**

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Net income (loss) | \$ 18,301 | \$ 29,525 | \$ (837,493) | \$ 113,136 |
| Other comprehensive income (loss): | | | | |
| Net change in unrealized gains (losses) during the period: | | | | |
| Residual interests in securitized loans | (1,999) | (4,023) | (8,408) | 2,010 |
| Investment securities | 2,608 | (149) | 2,607 | 1,909 |
| | 609 | (4,172) | (5,801) | 3,919 |
| Less income tax expense (benefit) | 246 | (1,656) | (2,297) | 1,514 |
| Other comprehensive income (loss) | 363 | (2,516) | (3,504) | 2,405 |
| Total comprehensive income (loss) | \$ 18,664 | \$ 27,009 | \$ (840,997) | \$ 115,541 |

2007 QUARTERLY REPORT 5

Table of Contents

**Fremont General Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited)**

NOTE 1 BASIS OF PRESENTATION

Overview

Fremont General Corporation (Fremont General or when combined with its subsidiaries, the Company) is a financial services holding company. Fremont General's financial services operations are consolidated within Fremont General Credit Corporation (FGCC), through its California industrial bank subsidiary, Fremont Investment & Loan (FIL). FIL offers certificates of deposit and savings and money market deposit accounts through its 22 retail banking branches in California. FIL's deposit accounts are insured up to the maximum legal limit by the Federal Deposit Insurance Corporation (FDIC). For portions of the nine month period ended September 30, 2007, the Company was engaged in commercial and residential (consumer) real estate lending businesses on a nationwide basis.

Exit from Sub-prime Mortgage Business; Cease and Desist Order. During 2007, the sub-prime residential real estate market experienced a significant deterioration that included increases in borrower delinquencies and a deterioration of credit that resulted in a substantial increase in the amount of loan repurchases and repricings on the Company's residential real estate whole loan sales. These repurchases and repricings were due primarily to early payment defaults and breaches of representations and warranties. As a result of the increase in repurchases and repricings, during the third quarter of 2007, the Company recorded provisions of \$5.3 million and \$9.0 million to its residential real estate loan valuation and repurchase reserves, respectively, and \$523.0 million and \$265.6 million, respectively, during the nine months ended September 30, 2007. For further information concerning activity in these reserves during 2007 and the comparable period in 2006 see Note 6.

On March 2, 2007, the Company announced that it intended to exit its sub-prime residential real estate lending operations. This move was consistent with regulatory guidelines issued that day, and was prompted by the Company's receipt on February 27, 2007 of a proposed Cease and Desist Order (the Order) from the FDIC calling for the Company to make a variety of changes designed to restrict the level of lending in its sub-prime residential mortgage business as well as the Company's analysis of the deterioration of the sub-prime residential real estate market. On March 7, 2007, the Company announced that it had ceased entering into new funding commitments with respect to sub-prime mortgage loans, although it would honor remaining outstanding commitments.

On March 7, 2007, Fremont General, FGCC and FIL consented to the Order without admitting to the allegations contained in the Order.

The Order requires, among other things, that FIL make a variety of changes in its sub-prime residential loan origination business and also calls for certain changes in its commercial real estate lending business. As more fully described elsewhere in this report, the Company has exited its sub-prime residential real estate operations and has sold its commercial real estate lending business and related loan portfolio. In addition, the Order requires that FIL adopt a Capital Adequacy Plan to maintain adequate Tier-1 Leverage capital in relation to its risk profile. Further, the Order mandates various specific management requirements, including having and retaining qualified management acceptable to the FDIC and the Department of Financial Institutions of the State of California (DFI), and provides for enhanced regulatory oversight over FIL's operations. The Order is more fully described in a Current Report on Form 8-K filed by the Company on March 7, 2007.

Residential Real Estate Transactions. On March 21, 2007, the Company announced that FIL had entered into whole loan sale agreements to sell approximately \$4 billion of its sub-prime residential real estate loans. On April 16, 2007, the Company announced that FIL had entered into an agreement to sell another \$2.9 billion of sub-prime residential

real estate loans, which represented the majority of the Company's sub-prime residential loans held for sale that had not yet been sold. The Company is in discussions with various parties with respect to the sale of the Company's sub-prime residential loan servicing platform and other assets. There can be no assurances that the Company will be able to enter into any transaction with respect to such business. In addition, given the significant market challenges that currently exist in the residential real

6 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

estate sector, even if such transactions are completed, there can be no assurances that the consideration received in such sales will provide substantial benefit to the Company's operating results or financial position.

For further information concerning the remaining assets and liabilities of the Company's discontinued residential real estate operations see Note 6.

Commercial Real Estate Transaction. On July 2, 2007, FIL completed the disposition of its commercial real estate lending business and related loan portfolio to iStar Financial Inc. (iStar) pursuant to an Asset Purchase Agreement entered into on May 21, 2007. FIL sold its entire \$6.27 billion commercial real estate loan portfolio and majority of the non-loan assets used in the business to iStar and received \$1.89 billion in cash plus a \$4.2 billion participation interest in the sold portfolio. The \$1.89 billion in cash represented 30% of the unpaid principal balance of the loan portfolio as of the closing, net of a purchase discount. The \$4.2 billion participation interest in the total loan portfolio represented 70% of the unpaid principal balance of the loan portfolio as of the closing, net of a purchase discount. The participation interest bears interest at LIBOR + 150 basis points. FIL's participation interest in the loan portfolio is governed by a participation agreement pursuant to which FIL is entitled to receive 70% of all principal payments on the loans sold to iStar, including with respect to any portion of the unfunded commitments with respect to such loans that are subsequently funded by iStar. In connection with the transaction, iStar assumed all obligations with respect to the loan portfolio after the closing date (including the obligation to fund approximately \$3.72 billion of existing unfunded commitments) and the obligations under certain assumed leases and intellectual property contracts. As of the closing date, iStar employed substantially all of the employees previously engaged in the Company's commercial real estate lending business. For further information concerning the results of the sale of the commercial real estate loan portfolio and related assets to iStar see Notes 5 and 8.

Third Quarter Operations. As described above, by the beginning of the third quarter of 2007, the Company had disposed of its residential real estate loan origination operations, a significant portion of its remaining residential real estate assets and had completed the sale of its commercial real estate lending business and related loan portfolio. The continuing operations that remained during the third quarter of 2007 consisted primarily of the Company's retail banking operations, which continued to accept and maintain retail deposit accounts. In addition, during the third quarter of 2007, the Company began recognizing interest income on the participation interest in the commercial real estate loan portfolio sold to iStar. With respect to its discontinued operations, during the third quarter of 2007 the Company continued to service residential real estate loans and recognize interest income on its remaining residential real estate assets classified as held for sale.

Subsequent Events

Transaction with Gerald J. Ford. On May 21, 2007, Fremont General and FIL entered into an Investment Agreement with an entity controlled by Gerald J. Ford providing for the acquisition by an investor group led by Mr. Ford of a combination of approximately \$80 million in exchangeable non-cumulative preferred stock of FIL and warrants to acquire additional common stock of Fremont General. On September 26, 2007, the Company announced that it had been advised by Mr. Ford that, in light of certain developments pertaining to Fremont General and FIL, Mr. Ford was not prepared to consummate such transactions on the terms set forth in the Investment Agreement. The Company said that, while it did not necessarily agree with the factual positions taken by Mr. Ford, it was in discussions with Mr. Ford concerning revised terms under which an entity controlled by Mr. Ford would proceed with an \$80 million investment in exchangeable preferred stock of FIL and receive warrants to acquire additional common stock of Fremont General. On October 29, 2007, the Investment Agreement was terminated. On October 30, 2007, the Company announced that it had ceased discussions with Mr. Ford. The Company is continuing to explore strategic alternatives with the assistance of Credit Suisse Securities LLC. There can be no assurances as to whether or when it will be able to enter into an agreement with respect to or complete any such alternative.

Stockholder Rights Plan. On October 23, 2007, Fremont General entered into a Stockholder Rights Plan (the Rights Plan) under which one right was distributed as a dividend for each share of common stock held by stockholders of record as of the close of business on November 2, 2007. The Rights Plan has been adopted as

Table of Contents

a means to assist in the preservation of the use of previously accumulated net operating losses, as described below.

The Company has net operating losses (NOLs) that may in the future offset the Company's taxable income, if any. U.S. federal income tax law imposes significant limitations on the ability of a corporation to use its NOLs to offset income in circumstances where such corporation has experienced a change in ownership. Generally, there is a change in ownership if, at any time, one or more 5% stockholders have aggregate increases in their ownership in the corporation of more than 50 percentage points looking back over the prior three-year period. One of the principal reasons for adopting the Rights Plan is to dissuade investors from aggregating ownership in the Company and triggering such a change in ownership. The Rights Plan is designed to reduce the likelihood of a change in ownership by, among other things, discouraging any person or group from acquiring additional shares of the Company's common stock. The Rights Plan was not adopted in response to any effort to acquire control of the Company.

To help preserve the benefit of the NOLs, the Company intends to submit for stockholder approval at its 2008 Annual Meeting an amendment to its articles of incorporation to restrict certain acquisitions of the Company's common stock so as to reduce the likelihood of triggering a change in ownership as defined for purposes of preserving the NOL. The Board of Directors intends to terminate the Rights Plan if such amendment is approved.

Under the Rights Plan, each right initially will entitle stockholders to purchase a fraction of a share of preferred stock at a purchase price of \$12.00, subject to adjustment as provided in the Rights Plan. Subject to the exceptions and limitations contained in the Rights Plan, the rights generally will be exercisable only if a person or group acquires beneficial ownership of 5% or more of the Company's common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 5% or more of the Company's common stock. Unless earlier terminated, the rights will expire on November 2, 2017.

Discontinued Operations

As more fully described above, in March 2007, the Company decided to exit the residential real estate business and to sell substantially all of the assets related to such business. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), the Company has classified the residential real estate operations as discontinued operations as the cash flow of the business has been eliminated from its ongoing operations and the Company will no longer have any significant continuing involvement in the business. Therefore, the results of operations, financial position and cash flows of the Company's residential real estate operations are presented separately in the consolidated financial statements and notes as discontinued operations for all periods presented.

When an operation meets the criteria for held for sale accounting as defined in SFAS No. 144, the operation is evaluated to determine whether the carrying value exceeds its fair value less costs to sell. Any loss resulting from the carrying value exceeding the fair value less costs to sell is recorded in the statement of operations in the period the operation meets the criteria for held for sale accounting. Management judgment is required to both assess the criteria required for held for sale accounting as well as to estimate fair value. Changes in the operation could cause it to no longer qualify for held for sale accounting and changes in fair value could result in an increase or decrease to previously recognized losses. For additional information concerning the Company's discontinued operations see Note 6.

General

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements include the accounts and operations of Fremont General and its subsidiaries including those variable interest entities where the Company is the primary

beneficiary. All intercompany balances and transactions have been eliminated in consolidation.

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that materially affect the reported amounts of assets and liabilities and the

8 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

disclosure of contingent liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, all adjustments considered necessary for the fair presentation of the interim financial statements have been included. See Note 6 for additional information concerning the results of the Company's discontinued operations and Note 8 for information concerning the gain on sale and exit costs related to the disposal of the Company's commercial real estate lending business and related loan portfolio.

The operating results for the nine month period ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

NOTE 2 RECENT ACCOUNTING STANDARDS

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 and 140 (SFAS No. 155). SFAS No. 155 requires companies to evaluate their interests in securitized financial assets and determine whether the interests are freestanding derivatives or hybrid financial instruments that may be subject to bifurcation. SFAS No. 155 provides companies with relief from having to separately determine the fair value of an embedded derivative that would otherwise be required to be bifurcated from its host contract in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 155 also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Company adopted SFAS No. 155 as of January 1, 2007 without any significant impact on the Company's financial position or results of operations.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140 (SFAS No. 156). SFAS No. 156 requires entities to separately recognize a servicing asset or liability when undertaking an obligation to service a financial asset under a servicing contract in certain situations, including a transfer of the servicer's financial assets that meets the requirements for sale accounting. SFAS No. 156 requires that any such servicing asset or liability be initially measured at fair value, if practicable, and then provides the option to either: (1) carry the mortgage servicing rights (MSRs) at fair value with changes in fair value recognized in current period earnings; or (2) continue recognizing periodic amortization expense and assess the MSRs for impairment as originally required by SFAS No. 140. The Company adopted SFAS No. 156 effective January 1, 2007 without any impact; electing to continue to record periodic amortization expense as originally required under SFAS No. 140.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a two-step approach for the recognition and measurement of a tax position taken or expected to be taken in an entity's tax return. The first step in the evaluation of a tax position is recognition: The Company must determine whether it is more likely than not that a given tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In this evaluation the Company must presume that the position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. The second step is measurement: A tax position meeting the

more-likely-than-not recognition threshold is recorded at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The Company adopted FIN No. 48 effective January 1, 2007 resulting in a charge to beginning retained earnings of approximately \$3.4 million. See Note 9 for further information on the impact of adopting FIN No. 48 and other tax related information.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and provides for

Table of Contents

expanded disclosures concerning fair value measurements. SFAS No. 157 retains the exchange price notion in earlier definitions of fair value; however, focuses on the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). SFAS No. 157 also establishes a fair value hierarchy used to classify the source of information used by the entity in fair value measurements. That is, assumptions developed based on market data obtained from independent sources (observable inputs) versus the entity's own assumptions about market assumptions developed based on the best information available in the circumstances (unobservable inputs). The Company is currently evaluating the impact of adopting SFAS No. 157; however, the Company does not believe the adoption will have a significant impact on its financial position or results of operations. SFAS No. 157 is effective for the Company's fiscal year beginning January 1, 2008.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115" (SFAS No. 159). SFAS No. 159 allows entities the option to measure many financial instruments and certain other items at fair value at specified election dates with changes in fair value reported in earnings. The fair value option may be applied on an instrument by instrument basis (with some exceptions), is irrevocable (unless a new election date occurs) and is applied only to entire instruments and not to portions of instruments. The FASB indicated that the objective of this statement is to improve financial reporting by providing entities the opportunity to mitigate volatility in reported earnings that are caused by measuring related assets and liabilities differently, without having to apply complex hedge accounting provisions. The Company is currently evaluating the impact of adopting SFAS No. 159. SFAS No. 159 is effective for the Company's fiscal year beginning January 1, 2008.

NOTE 3 CASH AND CASH EQUIVALENTS

Cash and cash equivalents are summarized in the following table as of the dates indicated:

| (Thousands of dollars) | September 30, 2007 | December 31, 2006 |
|--|-----------------------|----------------------|
| Cash on hand | \$ 584 | \$ 248 |
| Deposits in other financial institutions | 2,520 | 118,228 |
| FHLB shareholder transaction account | 10,000 | 397,548 |
| Federal Reserve account | 370,699 | 2,078 |
| U.S. Government, Agency and money market funds | 2,227,103 | 169,545 |
| Short-term money market funds | 47,162 | 46,971 |
| Short-term commercial paper | | 27,024 |
| Total cash and cash equivalents | \$ 2,658,068 | \$ 761,642 |

The FHLB shareholder transaction account represents a short-term interest-bearing account with the Federal Home Loan Bank of San Francisco. The Company's commercial paper holdings have ratings of A1 / P1 / F1 or better. The short-term money market funds have AAA / Aaa money market fund ratings. As of September 30, 2007, \$1.3 million in deposits in other financial institutions were restricted. No other cash and cash equivalents were restricted as of September 30, 2007 and December 31, 2006.

NOTE 4 INVESTMENT SECURITIES CLASSIFIED AS AVAILABLE-FOR-SALE

The amortized cost, unrealized gains, unrealized losses and fair value of the Company's investment securities classified as available-for-sale as of September 30, 2007 were as follows:

| (Thousands of dollars) | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|--|-------------------|---------------------|----------------------|---------------|
| Agency mortgage-backed securities classified as available-for-sale | \$ 1,174,751 | \$ 1,123 | \$ (16) | \$ 1,175,858 |

10 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

There were no realized gains or losses on the available-for-sale securities during the nine months ended September 30, 2007. Unrealized gains or losses are included in other comprehensive income.

NOTE 5 PARTICIPATION INTEREST

As more fully described in Note 1, on July 2, 2007, FIL completed the sale of its commercial real estate lending business and related loan portfolio to *iStar*. FIL sold its entire \$6.27 billion commercial real estate loan portfolio and majority of the non-loan assets used in the business to *iStar* and received \$1.89 billion in cash plus a \$4.2 billion participation interest in the sold portfolio. The terms of the agreement call for *iStar* to provide the Company with principal paydowns on a monthly basis plus interest payments on the unpaid principal balance at LIBOR + 150 basis points. The following table summarizes the activity in the Company's participation interest for the period indicated.

| (Thousands of dollars) | Three Months Ended September 30, 2007 |
|---------------------------------|--|
| Beginning balance | \$ |
| Participation interest received | 4,201,208 |
| Principal payments | (576,948) |
| Ending balance | \$ 3,624,260 |

During the three months ended September 30, 2007, the Company recognized \$70.7 million in interest income on the participation interest.

NOTE 6 DISCONTINUED OPERATIONS

As more fully described in Note 1, in March 2007, the Company decided to exit the residential real estate business and sell substantially all of the assets related to such business. The Company has determined there are no migration of revenues or costs as defined in EITF 03-13, Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations (EITF 03-13), since the Company is disposing of substantially all of its residential real estate operations and assets. In addition, although continuing cash flows may occur related to loan repurchases and repricings the Company is obligated to make in subsequent periods under standard industry representations and warranties for its residential real estate whole loan sales, the resolution of these contingencies do not constitute continuing cash flows or continuing involvement as defined in EITF 03-13. Therefore, in accordance with SFAS No. 144, the results of operations, financial position and cash flows of the Company's residential real estate operations are presented separately in the consolidated financial statements and notes as discontinued operations for all periods presented.

Table of Contents**Assets and Liabilities of Discontinued Operations**

The major classifications of assets and liabilities of the Company's discontinued operations are summarized as follows as of the dates indicated:

| (Thousands of dollars) | September 30, 2007 | December 31, 2006 |
|--|-----------------------|----------------------|
| Residential real estate loans held for sale - net | \$ 511,738 | \$ 4,949,747 |
| Servicing advances | 264,242 | 92,175 |
| Mortgage servicing rights - net | 47,974 | 101,172 |
| Real Estate Owned | 26,532 | 12,790 |
| Residual interests in securitized loans at fair value | 16,728 | 85,468 |
| Loans receivable | 10,917 | 8,568 |
| Accrued interest receivable | 5,118 | 18,572 |
| Investment securities classified as available-for-sale | 16,295 | 21,282 |
| Other assets | 7,281 | 26,146 |
| | | |
| Total assets to be sold | \$ 906,825 | \$ 5,315,920 |
| Loan repurchase reserve | \$ 100,104 | \$ 140,923 |
| Premium repurchase and recapture reserves | 61 | 8,442 |
| Federal Home Loan Bank advances | | 1,060,000 |
| Other liabilities | 14,285 | 97,840 |
| | | |
| Total liabilities | \$ 114,450 | \$ 1,307,205 |

Residential Real Estate Loans Held for Sale and Valuation Reserve: Residential real estate loans held for sale are aggregated prior to their sale and are carried at the lower of aggregate cost or estimated fair value less costs to sell. Estimated fair values are based upon current secondary market prices for loans with similar coupons, maturities and credit quality. The following tables detail the residential real estate loans held for sale included in discontinued operations and the valuation reserve to adjust the loans to estimated fair value less costs to sell as of the dates indicated:

| Residential Real Estate Loans Held For Sale (Thousands of dollars) | September 30, 2007 | December 31, 2006 |
|---|-----------------------|----------------------|
| Loan principal balance: | | |
| First trust deeds | \$ 836,977 | \$ 4,843,547 |
| Second trust deeds | 155,335 | 345,845 |

Edgar Filing: FREMONT GENERAL CORP - Form 10-Q

| | | |
|---|-------------------|--------------|
| | 992,312 | 5,189,392 |
| Net deferred direct origination costs | 3,682 | 38,940 |
| | 995,994 | 5,228,332 |
| Valuation reserve | (484,256) | (278,585) |
| Loans held for sale - net | \$ 511,738 | \$ 4,949,747 |
| Loans held for sale on non-accrual status | \$ 221,500 | \$ 64,652 |

| Valuation Reserve | Three Months Ended | | Nine Months Ended | |
|----------------------------------|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| (Thousands of dollars) | 2007 | 2006 | 2007 | 2006 |
| Beginning balance | \$ 481,838 | \$ 74,433 | \$ 278,585 | \$ 32,753 |
| Provision | 5,321 | 39,820 | 522,984 | 87,100 |
| Discounted sales | (103,004) | (61,928) | (574,031) | (111,416) |
| Charge-offs | (18,405) | (4,419) | (31,356) | (9,289) |
| Transfer from repurchase reserve | 118,506 | 48,379 | 288,074 | 97,137 |
| Ending balance | \$ 484,256 | \$ 96,285 | \$ 484,256 | \$ 96,285 |

12 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

In cases where the borrower experiences difficulties and the Company makes certain concessionary modifications to contractual terms (typically a reduction of the interest rate charges), the loan is classified as modified (i.e. restructured) accruing loan if the loan is performing in accordance with the agreed upon modified loan terms and projected cash proceeds are deemed sufficient to repay both principal and interest.

During the third quarters of 2007 and 2006, the Company modified residential real estate loans with a total unpaid principal balance of approximately \$22.2 million and \$0.0 million, respectively. During the first nine months of 2007 and 2006, the Company modified residential real estate loans with a total unpaid principal balance of approximately \$28.9 million and \$0.0 million, respectively. Modified residential real estate loans on accrual status as of September 30, 2007 and 2006 was \$10.0 million and \$0.0 million, respectively.

Servicing Advances: As a loan servicer, the Company is required to make certain advances on specific loans it is servicing to the securitization trusts that hold the loans, and loans owned by the Company, to the extent such advances are deemed collectible by the Company, from collections related to the individual loans. The total amount of servicing advances outstanding was \$264.2 million and \$92.2 million as of September 30, 2007 and December 31, 2006, respectively.

Mortgage Servicing Rights: The following table summarizes the activity in the Company's mortgage servicing rights asset within discontinued operations for the periods indicated:

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Beginning balance | \$ 75,505 | \$ 62,739 | \$ 101,677 | \$ 46,022 |
| Additions (sales) | | 35,119 | 5,495 | 68,739 |
| Amortization | (7,302) | (12,975) | (38,969) | (29,878) |
| Ending balance before valuation allowance | 68,203 | 84,883 | 68,203 | 84,883 |
| Valuation allowance: | | | | |
| Beginning balance | (12,735) | | (505) | |
| Provision for temporary impairment | (7,494) | | (19,724) | |
| Ending balance | (20,229) | | (20,229) | |
| Mortgage servicing rights net | \$ 47,974 | \$ 84,883 | \$ 47,974 | \$ 84,883 |
| Estimated fair value | \$ 53,279 | \$ 90,967 | \$ 53,279 | \$ 90,967 |

The key economic assumptions used in subsequently measuring the fair value of the Company's MSR's as of the dates indicated are as follows:

| September 30, | December 31, |
|---------------|--------------|
| 2007 | 2006 |

| | | |
|--|--------------|-------|
| Weighted-average life (years) | 1.8 | 1.4 |
| Weighted-average annual prepayment speed | 25.4% | 38.8% |
| Weighted-average annual discount rate | 19.8% | 19.6% |

Residual Interests in Securitized Loans: The following table summarizes the activity of the Company's retained residual interests within discontinued operations for the periods indicated:

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------|-------------------------------------|------------|------------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Beginning balance at fair value | \$ 34,932 | \$ 107,535 | \$ 85,468 | \$ 170,723 |
| Additions (sales) | | 22,642 | | (41,994) |
| Interest accretion | 7,184 | 8,946 | 21,409 | 41,705 |
| Cash received | (19,240) | (2,401) | (72,634) | (33,993) |
| Change in unrealized losses | (1,999) | (4,023) | (8,408) | 2,010 |
| Other-than-temporary impairment | (4,149) | | (9,107) | (5,752) |
| Ending balance at fair value | \$ 16,728 | \$ 132,699 | \$ 16,728 | \$ 132,699 |

Table of Contents

The following table summarizes delinquencies and credit losses for the loans underlying the Company's outstanding securitization transactions as of the dates indicated:

| | September 30, | | December 31, | |
|---|---------------|-------------------|--------------|------------|
| (Thousands of dollars) | 2007 | | 2006 | |
| Original principal amount of loans securitized | \$ | 17,536,329 | \$ | 17,536,329 |
| Current principal amount of loans securitized | \$ | 8,809,326 | \$ | 10,938,440 |
| Current delinquent principal amount (over 60 days) | \$ | 1,891,265 | \$ | 1,142,794 |
| Inception to date credit losses (net of recoveries) | \$ | 188,577 | \$ | 53,241 |

Key economic assumptions used in subsequently measuring the fair value of the Company's residual interests as of the dates indicated are as follows:

| | September 30, | | December 31, | |
|--|---------------|--------------|--------------|-------|
| | 2007 | | 2006 | |
| Weighted-average life (years) | | 2.6 | | 2.5 |
| Weighted-average annual prepayment speed | | 28.2% | | 25.0% |
| Weighted-average lifetime credit losses | | 5.7% | | 5.5% |
| Weighted-average annual discount rate | | 35.0% | | 24.0% |

Loan Repurchase Reserve: As the residential real estate loans held for sale are sold, the Company makes standard industry representations and warranties about the loans. The Company may have to subsequently repurchase certain loans due to defects that occurred in the origination of the loans. During the third quarters of 2007 and 2006, the Company repurchased a total of \$279.1 million and \$294.2 million in loans, respectively. During the first nine months of 2007 and 2006, the Company repurchased a total of \$931.8 million and \$532.8 million in loans, respectively. The following table summarizes the activity in the repurchase reserve related to residential loans which is included in discontinued operations for the periods indicated:

| | Three Months Ended | | Nine Months Ended | |
|--------------------------------|--------------------|------------------|-------------------|----------|
| | September 30, | | September 30, | |
| (Thousands of dollars) | 2007 | 2006 | 2007 | 2006 |
| Beginning balance | \$ | 214,638 | \$ | 57,586 |
| Provision | | 9,047 | | 31,184 |
| Charge-offs for loan repricing | | (5,075) | | (6,199) |
| Transfer to valuation reserve | | (118,506) | | (48,379) |
| | \$ | 140,923 | \$ | 14,556 |
| | | 265,636 | | 141,479 |
| | | (18,381) | | (24,706) |
| | | (288,074) | | (97,137) |

| | | | | | | | | |
|----------------|----|----------------|----|--------|----|----------------|----|--------|
| Ending balance | \$ | 100,104 | \$ | 34,192 | \$ | 100,104 | \$ | 34,192 |
|----------------|----|----------------|----|--------|----|----------------|----|--------|

Premium Repurchase and Recapture Reserve: The Company also maintains a reserve for premium recapture that represents the estimate of probable refunds of premiums received on previously completed loan sales (either due to early loan prepayments or for certain loans repurchased from prior sales) that are expected to occur under the provisions of the various agreements entered into for the sale of its residential real estate loans held for sale. The following table summarizes the activity in the premium recapture reserve within discontinued operations for the periods indicated:

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | | | | | |
|--|-------------------------------------|-----------------|------------------------------------|----------|----|-----------------|----|----------|
| | 2007 | 2006 | 2007 | 2006 | | | | |
| Beginning balance | \$ | 436 | \$ | 10,661 | \$ | 8,442 | \$ | 4,259 |
| Provision for premium recapture on repurchased loans | | (11,523) | | 2,858 | | (20,065) | | 12,629 |
| Provision for standard premium recapture | | | | 2,855 | | (568) | | 10,484 |
| Refunds | | 11,148 | | (10,041) | | 12,252 | | (21,039) |
| Ending balance | \$ | 61 | \$ | 6,333 | \$ | 61 | \$ | 6,333 |

Table of Contents**Operating Results of Discontinued Operations**

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Interest income | \$ 16,954 | \$ 144,379 | \$ 217,656 | \$ 484,841 |
| Non-interest income | 3,142 | 4,918 | (865,124) | 22,538 |
| Revenues from discontinued operations | \$ 20,096 | \$ 149,297 | \$ (647,468) | \$ 507,379 |
| Loss on sale of discontinued operations | \$ (4,141) | \$ (9,623) | \$ (881,116) | \$ (16,425) |
| Interest income | 16,954 | 144,379 | 217,656 | 484,841 |
| Interest expense | (15,357) | (86,270) | (146,361) | (262,090) |
| Provision for loan loss | 15 | (5) | | 8 |
| Loan servicing income | 26,647 | 26,427 | 90,314 | 71,258 |
| Mortgage servicing rights amortization and impairment provision | (14,796) | (12,975) | (61,893) | (29,878) |
| Impairment on residual interests | (5,148) | | (15,479) | (5,752) |
| Other non-interest income | 580 | 1,089 | 3,050 | 3,335 |
| Compensation and related | (13,959) | (29,868) | (83,362) | (94,125) |
| Occupancy | (4,879) | (4,929) | (19,725) | (13,885) |
| Other non-interest expense | (9,291) | (16,391) | (65,213) | (42,760) |
| Income (loss) from discontinued operations | (23,375) | 11,834 | (962,129) | 94,527 |
| Income tax (expense) benefit | 9,480 | (4,986) | 92,356 | (38,101) |
| Income (loss) from discontinued operations, net of income taxes | \$ (13,895) | \$ 6,848 | \$ (869,773) | \$ 56,426 |

The loss from discontinued operations, net of income taxes, was \$13.9 million for the third quarter of 2007, representing a \$0.18 diluted loss per share, compared to income from discontinued operations, net of income taxes, of \$6.8 million, or \$0.09 diluted income per share for the third quarter of 2006. During the first nine months of 2007, the loss from discontinued operations, net of income taxes, was \$869.8 million, representing a \$11.25 diluted loss per share, compared to income from discontinued operations, net of income taxes, of \$56.4 million, or \$0.74 diluted income per share for the comparable period in 2006.

In accordance with SFAS No. 128, Earnings per Share, for the three and nine months ended September 30, 2007, the Company calculated the diluted loss per share from discontinued operations, net of income taxes, using the same number of potential common shares used in computing the diluted income per share from continuing operations even though the results were antidilutive with respect to the discontinued operations basic per share amounts.

During the third quarter of 2007, the Company recorded a realized loss of \$4.1 million, net of valuation reserves, related to the sale of \$234.9 million of residential real estate loans held for sale. During the nine months ended September 30, 2007, the Company recognized a loss of \$881.1 million, net of valuation reserves related to the sale of

\$8.75 billion of residential real estate loans held for sale. Expense provisions related to the residential real estate loan valuation, repurchase and premium recapture reserves are included in these losses. In addition, during third quarter and the first nine months of 2007, the Company recognized \$664,000 and \$39.4 million, respectively, in adjustments to write down the carrying value of the residential real estate held for sale assets to their estimated fair value less costs to sell.

During the third quarters of 2007 and 2006, the Company recognized \$8.9 million and \$123.0 million, respectively, in interest income on the residential real estate loan portfolio. During the nine months ended September 30, 2007 and 2006, the Company recognized \$195.4 million and \$396.5 million, respectively, in interest income on the residential real estate loan portfolio.

During the third quarter of 2007, the Company continued to service residential real estate loans, recognizing loan servicing income of \$26.6 million as compared to \$26.4 million during the third quarter of 2006. During the nine months ended September 30, 2007 and 2006, the Company recognized \$90.3 million and \$71.3 million, respectively, in loan servicing income. The Company was servicing to maturity \$15.38 billion and \$18.12 billion in principal balance of loans as of September 30, 2007 and December 31, 2006, respectively.

The loss from discontinued operations for the three and nine months ended September 30, 2007 includes \$4.8 million and \$10.1 million, respectively, in charges for one time severance payments paid to employees of the residential real estate loan origination operations and related support staff. In addition, during the same

Table of Contents

periods, the Company recorded \$4.0 million and \$14.7 million, respectively, of charges for lease termination costs related to the Company's residential real estate loan origination offices.

During the nine months ended September 30, 2007, cash flows related to residential real estate loan originations and proceeds realized on the sale of such loans were \$3.89 billion and \$7.81 billion, respectively, and during the nine months ended September 30, 2006, such cash flows were \$25.84 billion and \$25.31 billion, respectively. These amounts are included in cash flows from operating activities in the Company's consolidated statements of cash flows.

NOTE 7 REAL ESTATE OWNED

The Company's real estate owned (REO) consists of property acquired through or in lieu of foreclosure on loans secured by real estate. REO is reported in the financial statements at the lower of cost or estimated realizable value (net of estimated costs to sell). REO consisted of the following as of the dates indicated:

| (Thousands of dollars) | September 30, 2007 | December 31, 2006 |
|-------------------------|-----------------------|----------------------|
| Commercial real estate | \$ | \$ 299 |
| Valuation reserve | | |
| Real estate owned - net | \$ | \$ 299 |

During the third quarter of 2007, the Company disposed of its remaining commercial REO property.

NOTE 8 SALE OF COMMERCIAL REAL ESTATE LOANS AND EXIT AND DISPOSAL COSTS

As more fully described in Note 1, the Company completed the sale of its entire \$6.27 billion commercial real estate loan portfolio and majority of the non-loan assets used in the business to *iStar* in July 2007, and received cash of \$1.89 billion and a 70% participation interest of \$4.2 billion in the loans sold. Due to the participation, cash flows from the component will not be eliminated from the Company's ongoing operations. Because the Company expects significant cash inflows will be received as a result of the continuation of activities between itself and the commercial real estate component, the sale does not result in the classification of the commercial real estate operation as discontinued, as defined by EITF No. 03-13. Based on management's decision to sell the commercial loan portfolio in the first quarter of 2007, the Company reclassified the commercial real estate loans from held for investment to held for sale. The Company recorded a \$65.6 million gain during the third quarter of 2007 related to the sale of the commercial real estate loan portfolio and related assets to *iStar* as detailed in the tables below:

(Thousands of dollars)

SALE OF COMMERCIAL REAL ESTATE LOANS

| | |
|---------------------------|--------------|
| Loans outstanding (gross) | \$ 6,270,667 |
| Accrued interest | 43,219 |
| Discount | (268,942) |

| | |
|--|------------------|
| Net price | 6,044,944 |
| Loans outstanding | 6,263,168 |
| Unamortized deferred origination fees and costs | (45,470) |
| Carrying value adjustment | (232,465) |
| Accrued interest and other | 41,568 |
| Commercial real estate loans carrying value and accrued interest | 6,026,801 |
| Gain on sale of commercial real estate loans | \$ 18,143 |
| (Thousands of dollars) | |
| SALE OF COMMERCIAL REAL ESTATE ASSETS | |
| Cash received | \$ 50,000 |
| Carrying value of assets sold | 2,486 |
| Gain on sale of other assets | \$ 47,514 |

Table of Contents

In connection with the *iStar* sale, approximately 131 employees in the commercial real estate loan origination operation transferred to *iStar*. In accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, the Company recorded employee severance charges for terminated employees that did not transfer to *iStar* in the amounts of \$129,000 and \$6.3 million, respectively, as part of compensation and related costs during the third quarter and first nine months of 2007. In addition, during the third quarter and first nine months of 2007, the Company incurred \$1.3 million and \$2.6 million, respectively, in other charges related to the sale of the commercial real estate loan origination operation and related loan portfolio. These charges are included in other non-interest expense in the consolidated statements of operations.

During the first nine months of 2007, the Company recognized losses of \$1.8 million related to the sale of commercial real estate loans unrelated to the *iStar* transaction.

NOTE 9 INCOME TAXES

The major components of income tax expense from continuing operations are summarized in the following table:

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Federal: | | | | |
| Current | \$ (2,606) | \$ 15,495 | \$ 8,484 | \$ 26,732 |
| Deferred | 20,572 | (2,715) | 13,035 | 6,196 |
| | 17,966 | 12,780 | 21,519 | 32,928 |
| State: | | | | |
| Current | (538) | (588) | 1,767 | 1,396 |
| Deferred | 4,310 | (2) | 1,232 | 473 |
| | 3,772 | (590) | 2,999 | 1,869 |
| Total income tax expense (benefit) | \$ 21,738 | \$ 12,190 | \$ 24,518 | \$ 34,797 |

For the nine month period ended September 30, 2007, the Company recorded an income tax benefit relating to its discontinued operations of \$(92.4) million for 2007 of which \$(133.0) million was current and \$40.6 million was deferred. Included in the deferred tax expense was an addition to the deferred tax asset valuation allowance of \$277.1 million. During the first nine months of 2006, the Company recorded an income tax expense relating to its discontinued operations of \$38.1 million of which \$66.0 million was current and \$(27.9) million was deferred.

The deferred income tax balance includes the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for income tax purposes. The components of the Company's

deferred tax assets are summarized in the following table:

| | September 30, | December 31, |
|---|------------------|--------------|
| (Thousands of dollars) | 2007 | 2006 |
| Deferred tax assets: | | |
| Mark-to-market on loans held for sale | \$ | \$ 7,398 |
| Premium recapture and repurchase reserves | 42,249 | 62,136 |
| Allowance for loan losses | 2,053 | 40,262 |
| Compensation related items | 53,453 | 29,150 |
| Net operating loss carryforward | 262,556 | 21,005 |
| Other net | 9,144 | 164 |
| | | |
| Total deferred tax assets | 369,455 | 160,115 |
| Deferred tax liabilities: | | |
| Loan origination costs and fees | | (16,902) |
| Mortgage servicing | (19,716) | (37,718) |
| State income and franchise taxes | (37,653) | (17,924) |
| | | |
| Total deferred tax liabilities | (57,369) | (72,544) |
| | | |
| Net deferred tax asset before valuation allowance | 312,086 | 87,571 |
| Valuation allowance | (312,086) | (34,995) |
| | | |
| Net deferred tax asset after valuation allowance | \$ | \$ 52,576 |

Table of Contents

The Company has accrued the expected tax and interest exposure for tax matters that are either in the process of resolution or have been identified as having the potential for adjustment. These matters primarily consist of issues relating to the discontinued insurance operations, the apportionment of income to various states and the deduction of certain expenses.

In assessing the realization of deferred income tax assets, the Company considers whether it is more likely than not that the deferred income tax assets will be realized. The ultimate realization of deferred income tax assets depends on the ability to recover previously paid taxes through loss carrybacks and the generation of future taxable income during the periods in which temporary differences become deductible. At September 30, 2007, it was the Company's opinion that it was not likely that the deferred tax asset would be realized and a full valuation reserve was recorded for the deferred tax asset.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized an approximate \$3.4 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. The total amount of unrecognized tax benefits as of the date of adoption on January 1, 2007 was \$22.1 million, all of which would favorably affect the effective tax rate if recognized.

The Company records interest expense and penalties related to unrecognized tax benefits as a component of income tax expense. At January 1, 2007, the Company had accrued \$1.8 million and \$100,000 for the potential payments of interest and penalties.

The Internal Revenue Service is currently examining the Company's 2004, 2005 and 2006 income tax returns. The California Franchise Tax Board has examined the Company's franchise tax returns through the 2004 tax year.

NOTE 10 OTHER NON-INTEREST EXPENSE

Other non-interest expense categories for the third quarter and nine months ended September 30, 2007 and 2006 are summarized in the table below.

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Legal, professional and other outside services | \$ 11,551 | \$ 7,445 | \$ 33,061 | \$ 18,561 |
| Information technology | 2,142 | 4,520 | 8,714 | 11,944 |
| Printing, supplies and postage | 722 | 1,235 | 2,048 | 3,867 |
| Advertising and promotion | 651 | 1,811 | 3,764 | 5,398 |
| Auto and travel | 536 | 1,285 | 2,479 | 3,589 |
| Leasing and loan | 28 | 252 | 1,368 | 700 |
| Net real estate owned | (4,574) | 176 | (4,325) | (6,791) |
| Telephone | 428 | 617 | 2,028 | 2,019 |
| FDIC and DFI | 6,702 | 383 | 25,438 | 2,370 |
| Other | 1,264 | 1,867 | 1,566 | 7,459 |

| | | | | |
|----------------------------------|------------------|-----------|------------------|-----------|
| Total other non-interest expense | \$ 19,450 | \$ 19,591 | \$ 76,141 | \$ 49,116 |
|----------------------------------|------------------|-----------|------------------|-----------|

NOTE 11 DEBT FREMONT GENERAL CORPORATION

The debt of Fremont General is detailed in the following table; none of the Fremont General debt is guaranteed by FIL.

| | | September 30, | December 31, |
|---|-------------------|---------------|--------------|
| (Thousands of dollars) | | 2007 | 2006 |
| Senior Notes due 2009, less discount (2007 \$419; 2006 \$635) | \$ 166,111 | \$ 165,895 | |
| Junior Subordinated Debentures | 103,093 | 103,093 | |
| Total | \$ 269,204 | \$ 268,988 | |

During the nine months ended September 30, 2007, there were no repurchases of either Senior Notes or Junior Subordinated Debentures.

Table of Contents**NOTE 12 DEPOSITS, FHLB ADVANCES, FEDERAL RESERVE AND WAREHOUSE LINES OF CREDIT FIL**

During the first nine months of 2007, FIL utilized the issuance of deposits, which are insured up to the maximum legal limit by the FDIC, Federal Home Loan Bank (FHLB) advances, Federal Reserve and warehouse lines of credit in funding its operations.

As of September 30, 2007, the weighted-average interest rate for savings and money market deposit accounts was 4.13% and for certificates of deposit it was 5.18%. The weighted-average interest rate for all deposits at September 30, 2007 was 5.00%.

Certificates of deposit as of September 30, 2007 are detailed by maturity and rates as follows:

(Thousands of dollars, except percents)

| Maturing by September 30, | Amount | Weighted Average Rate |
|---------------------------|---------------------|-----------------------------|
| 2008 | \$ 6,479,981 | 5.18% |
| 2009 | 76,444 | 5.63% |
| 2010 | 10,476 | 4.88% |
| 2011 | 10,167 | 5.26% |
| 2012 | 8,957 | 4.99% |
| | \$ 6,586,025 | 5.18% |

Of the \$6.59 billion in total certificates of deposit outstanding at September 30, 2007, \$659.9 million were obtained through brokers.

Interest expense on deposits is summarized as follows:

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Savings and money market deposit accounts | \$ 15,949 | \$ 15,917 | \$ 53,908 | \$ 44,215 |
| Certificates of deposit | 99,175 | 97,973 | 322,675 | 267,102 |
| Penalties for early withdrawal | (392) | (186) | (1,590) | (543) |
| Total interest expense | \$ 114,732 | \$ 113,704 | \$ 374,993 | \$ 310,774 |

Interest expense in the table above reflects the net interest expense the Company incurred on its deposit accounts during the respective periods indicated. Interest expense is charged back to both the commercial real estate operations as well as the residential real estate (discontinued) operations for the use of funds generated by the Company's corporate and retail banking operations.

Total interest payments on deposits were \$121.9 million and \$114.8 million, during the third quarters of 2007 and 2006, respectively, and \$374.0 million and \$305.1 million for the nine months ended September 30, 2007 and 2006, respectively.

During the first six months of 2007, FIL utilized additional financing through advances from the FHLB. FIL's credit line with the FHLB had a maximum financing availability that was based on a percentage of FIL's regulatory assets, to which the actual borrowing capacity was subject to collateralization and certain collateral sublimits and eligibility limitations. In March 2007, following the issuance of the Order and the Company's exit from the residential real estate lending business, the FHLB limited FIL's borrowing capacity to existing outstanding debt of \$3.67 billion. By March 31, 2007, FIL had utilized \$2.30 billion in proceeds from loan sales and \$618.1 million in debt from a warehouse lending facility to reduce the outstanding FHLB debt to \$800.0 million. As of June 30, 2007, outstanding FHLB debt was zero and all pledged collateral was released by the FHLB to FIL. As of September 30, 2007 FIL did not maintain any pledged collateral with the FHLB.

In the first quarter of 2007, FIL pledged eligible commercial real estate loans to the Federal Reserve Bank of San Francisco under the Primary Credit program (the Program). There was no outstanding debt at any time during 2007 under the Program. In June 2007, in anticipation of the iStar Transaction, FIL removed all commercial real estate loans pledged as collateral under the Program. As of September 30, 2007, FIL did not maintain any pledged collateral with the Federal Reserve Bank.

Table of Contents

In the first quarter of 2007, in connection with the Company's exit from the residential real estate lending business, FIL mutually terminated two of four existing warehouse financing lines and elected to allow one financing facility to expire. As of March 31, 2007, outstanding debt on the remaining warehouse facility was \$618.0 million. On April 30, 2007 all outstanding debt on this facility was repaid. In June 2007, the remaining warehouse financing facility expired. As of September 30, 2007, FIL did not have any warehouse financing lines.

NOTE 13 OTHER ASSETS AND LIABILITIES

The following tables detail the composition of the Company's other assets and other liabilities as of the dates indicated:

| | September 30, | December 31, |
|--|---------------|--------------|
| (Thousands of dollars) | 2007 | 2006 |
| OTHER ASSETS | | |
| Federal and state(s) income taxes receivable | \$ 287,180 | \$ 220,936 |
| Assets held in SERP mutual funds | 26,377 | 33,536 |
| Other | 27,580 | 14,460 |
| | | |
| Total other assets | \$ 341,137 | \$ 268,932 |

| | September 30, | December 31, |
|----------------------------------|---------------|--------------|
| (Thousands of dollars) | 2007 | 2006 |
| OTHER LIABILITIES | | |
| Accounts payable | \$ 51,542 | \$ 30,256 |
| Deferred compensation obligation | 28,650 | 52,926 |
| Accrued interest payable | 27,060 | 29,884 |
| Accrued incentive compensation | 9,724 | 32,368 |
| Restricted stock accrual | 2,351 | 14,786 |
| Accrued ESOP expense | | 15,664 |
| Other | 22,602 | 34,702 |
| | | |
| Total other liabilities | \$ 141,929 | \$ 210,586 |

NOTE 14 SHARE-BASED PAYMENTS

Company stock award plans provide a long term compensation opportunity for officers and certain key employees of the Company. Stock options and awards of rights to purchase shares of the Company's common stock, generally in the form of restricted stock awards, may be granted under the 2006 Performance Incentive Plan (the "2006 Plan") that was approved by the Company's stockholders on May 18, 2006.

Stock Options

During the years 1989 to 1997, non-qualified stock options were granted at exercise prices equal to the fair value of the stock on the date of grant. Grantees vested at the rate of 25% per year beginning on the first anniversary of the grants that expire after ten years. The remaining 468,000 non-qualified option shares outstanding and exercisable as of December 31, 2006 expired in February 2007. There are no outstanding option shares as of September 30, 2007.

Restricted Stock Awards

Under SFAS No. 123(R), Share-Based Payment, the Company recognizes compensation expense related to its restricted stock awards based on the greater of the fair value of the shares awarded as of the grant date or the current fair value as of the reporting date. Compensation expense for the restricted stock awards is recognized on a straight-line basis over the requisite service period (generally two to ten years). The compensation expense (benefit) that has been charged against (credited to) income for share-based compensation was \$(1.1) million and \$3.3 million for the three months ended September 30, 2007 and 2006, respectively, and \$5.9 million and \$9.8 million for the nine months ended September 30, 2007 and 2006, respectively.

Table of Contents

A summary of the status of the Company's nonvested restricted stock awards as of September 30, 2007 and changes during the nine month period then ended is presented below:

| | Number of Shares | | Weighted Average Grant Date Fair Value |
|---------------------------------|---------------------|-----------|---|
| Nonvested at December 31, 2006 | 3,091,640 | \$ | 16.50 |
| Granted | 359,000 | | 5.47 |
| Vested | (849,010) | | 18.23 |
| Forfeited | (1,088,370) | | 15.38 |
| Nonvested at September 30, 2007 | 1,513,260 | \$ | 13.69 |

The fair value of nonvested restricted stock awards is determined based on the closing trade price of the Company's shares on the grant date. As of September 30, 2007, there was \$12.1 million of total unrecognized compensation cost related to nonvested restricted stock awards.

NOTE 15 DEFERRED COMPENSATION

The Company periodically contributes cash to an employee benefits trust (GSOP) in order to pre-fund contributions to various employee benefit plans (e.g., 401(K) match, Employee Stock Ownership Plan contribution, etc.).

The Company also maintains a Supplemental Executive Retirement Plan (SERP) and Excess Benefit Plan (EBP), both of which are deferred compensation plans designed to provide certain employees the ability to receive benefits that would be otherwise lost under the Company's qualified retirement plans due to statutory or other limits on salary deferral and matching contributions.

The following table details the composition of the Company's deferred compensation balance as of the dates indicated:

| (Thousands of dollars) | September 30, 2007 | December 31, 2006 |
|-----------------------------|-----------------------|----------------------|
| SERP and EBP | \$ 6,823 | \$ 18,209 |
| GSOP | 1,182 | 2,485 |
| Total deferred compensation | \$ 8,005 | \$ 20,694 |

NOTE 16 INDUSTRIAL BANK REGULATORY CAPITAL

FIL is subject to various regulatory capital requirements under California and Federal regulations. Failure to meet minimum capital requirements can result in regulatory agencies initiating certain mandatory and possibly additional discretionary actions that, if undertaken, could have a direct material effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, FIL must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. FIL's capital amounts, its ability to pay dividends and other requirements and classifications are also subject to qualitative judgments by its regulators about components, risk weightings and other factors.

The terms of the Order require FIL to submit to the FDIC a capital plan that includes a Tier-1 Leverage capital ratio of not less than 14%. FIL's actual regulatory amounts and ratios and the related standard regulatory

Table of Contents

minimum amounts and ratios required to qualify as well-capitalized are detailed in the following tables as of the dates indicated:

| (Thousands of dollars, except percents) | September 30, 2007 | | | |
|---|--------------------|--------|------------------|--------|
| | Actual | | Minimum Required | |
| | Amount | Ratio | Amount | Ratio |
| Tier-1 Leverage Capital | \$ 548,331 | 5.70% | \$ 1,345,617 | 14.00% |
| Risk-Based Capital: | | | | |
| Tier-1 | 548,331 | 10.45% | 314,837 | 6.00% |
| Total | 548,640 | 10.46% | 524,728 | 10.00% |

| (Thousands of dollars, except percents) | December 31, 2006 | | | |
|---|-------------------|--------|------------------|--------|
| | Actual | | Minimum Required | |
| | Amount | Ratio | Amount | Ratio |
| Tier-1 Leverage Capital | \$ 1,326,563 | 10.09% | \$ 657,061* | 5.00%* |
| Risk-Based Capital: | | | | |
| Tier-1 | 1,326,563 | 8.77% | 907,639 | 6.00% |
| Total | 1,392,814 | 9.21% | 1,512,732 | 10.00% |

* Based on the terms of the Order consented to on March 7, 2007, the minimum required amount and ratio would have been \$1,839,772 and 14%, respectively.

The following table details the calculation of the respective capital amounts at FIL as of the dates indicated:

| (Thousands of dollars) | September 30, | | December 31, | |
|---|---------------|----------------|--------------|-----------|
| | 2007 | | 2006 | |
| Common stockholder's equity at FIL | \$ | 549,917 | \$ | 1,326,557 |
| Less: Disallowed portion of deferred tax assets and mortgage servicing rights | | (23) | | |
| Net unrealized losses on available-for-sale securities | | (1,563) | | 6 |
| Total Tier-1 Capital | | 548,331 | | 1,326,563 |
| Add: Allowable portion of the allowance for loan losses | | 309 | | 66,251 |

| | | | | |
|--|----|----------------|----|-----------|
| Total Risk-Based Capital (Tier-1 and Tier-2) | \$ | 548,640 | \$ | 1,392,814 |
|--|----|----------------|----|-----------|

NOTE 17 COMMITMENTS AND CONTINGENCIES

Cleanup Call:

The Company retains the right in its securitization transactions to call the securities when the outstanding balance of loans in the securitization trust declines to a specific level, typically 10% of the original balance.

Termination Benefits:

As more fully described in Item 11. Executive Compensation, in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Annual Report), certain of the Company's executive officers are entitled to receive certain payments and benefits upon a Change-in Status, Company Event, and or Involuntary Termination, as such terms are defined in the 2006 Annual Report. Although the Company does not believe these payments are probable as such term is defined in SFAS No. 5, Accounting for Contingencies, the likelihood that such payments may be made in the foreseeable future is reasonably possible. The Company estimates that these payments and benefits, if they were to occur, could result in the Company recognizing as much as \$19 million in compensation expense in the period in which some or all of these events occurred.

Cease and Desist Order:

On March 7, 2007, the Company consented to an Order to Cease and Desist from the FDIC without admitting to the allegations contained in the Order. Should the FDIC or DFI deem the Company and/or its directors to have violated or otherwise failed to comply with the Order, civil money penalties could be imposed. The Company has and continues to expend considerable resources complying with the letter and spirit of the Order. FIL has filed its required quarterly progress reports with the FDIC and the DFI and it has not received any communications indicating non-compliance with the Order.

22 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

Legal Actions:

The Company is a defendant in a number of legal actions or regulatory proceedings arising in the ordinary course of business, from the discontinuance of the insurance operations and from regulatory examinations conducted by the FDIC and the DFI.

The following is a material legal proceeding filed during the third quarter of 2007 not previously reported. For further information concerning material pending and threatened litigation action and proceedings against the Company, see Note 23 Commitments and Contingencies, in Notes to Consolidated Financial Statements in the 2006 Annual Report.

Morgan Stanley v. Fremont Investment & Loan

On October 23, 2007, Morgan Stanley Mortgage Capital Holdings LLC filed a lawsuit in the United States District Court for the Southern District of New York against FIL alleging breaches with respect to residential mortgage loans it sold to Morgan Stanley between May 1, 2005 and December 28, 2006. The complaint alleges damages of at least \$10 million. The case is in its very early stages and the Company cannot predict the outcome or effect it will have on its financial condition. However, the Company believes the lawsuit is without merit and will vigorously defend against it.

NOTE 18 OPERATIONS BY REPORTABLE SEGMENT

As more fully described in Note 1, in the first quarter of 2007, the Company decided to exit the residential real estate business. Therefore, the results of operations of that business are now reported as discontinued operations and the Company only has a single reportable segment as defined by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS No. 131).

Although the Company sold its commercial real estate lending business and entire \$6.27 billion loan portfolio and majority of the non-loan assets used in the business to iStar in July 2007 and received cash of \$1.89 billion and a 70% participation interest of \$4.2 billion in the loans sold, as more fully described in Note 8, this continuing interest in the commercial real estate operations results in significant continuing cash flows between the Company and the commercial component. Therefore, the commercial real estate business does not meet the criteria of a discontinued operation and continues to be a reportable segment as defined by SFAS No. 131.

Through the first six months of 2007, the commercial real estate segment originated commercial real estate loans, which were primarily bridge and construction facilities, on a nationwide basis. Beginning in the first quarter of 2007, the Company reclassified these loans from held for investment to loans held for sale. The loans generated net interest income on the difference between the rates charged on the loans and the cost of borrowed funds. Beginning in the third quarter of 2007, the commercial real estate segment generated interest income on the participation interest in the commercial loan portfolio sold to iStar as described above.

Management measures and evaluates the commercial real estate segment based on net interest income and pre-tax operating results. The results of operations include certain allocated corporate expenses charged back to the commercial segment. In addition, interest expense is charged back to both the commercial segment as well as the (residential real estate) discontinued operations for the use of funds generated by the Company's corporate and retail banking operations. Interest expense is allocated to the commercial segment and discontinued operations using treasury rates matched to the terms of the respective loans.

Certain expenses that are centrally managed at the corporate level such as provision for income taxes and other general corporate expenses are excluded from the measure of segment profitability reviewed by management. The Company has included these general corporate expenses along with the results of the Company's retail banking operation, which does not meet the definition of a reportable segment, in the Corporate and Retail Banking category.

Intersegment eliminations shown in the following tables relate to the credit allocated to the retail banking operations for operating funds provided to the commercial segment.

Historical periods have been restated to conform to this presentation.

Table of Contents

| (Thousands of dollars) | Commercial Real Estate | Corporate and Retail Banking | Intersegment Eliminations | Total Consolidated |
|---|---------------------------|---------------------------------|------------------------------|-----------------------|
| Three months ended September 30, 2007 | | | | |
| Total revenues | \$ 90,274 | \$ 155,285 | \$ (49,496) | \$ 196,063 |
| Net interest income | \$ 22,636 | \$ 2,426 | \$ | \$ 25,062 |
| Provision for loan losses | (151) | | | (151) |
| Other non-interest income | 18,142 | 47,747 | | 65,889 |
| Compensation | 1,100 | (15,456) | | (14,356) |
| Occupancy | 637 | (3,697) | | (3,060) |
| Other non-interest expense Allocations | 4,290 | (23,740) | | (19,450) |
| Income before income taxes | 46,654 | 7,280 | | 53,934 |
| Income tax expense | | | | (21,738) |
| Income from continuing operations | 46,654 | 7,280 | | 32,196 |
| Loss from discontinued operations, net of income taxes | | | | (13,895) |
| Net income (loss) | \$ 46,654 | \$ 7,280 | \$ | \$ 18,301 |
| Assets continuing operations | \$ 33,401 | \$ 7,852,573 | \$ (1,732) | \$ 7,884,242 |
| Assets discontinued operations | | | | 906,825 |
| Total consolidated assets | \$ 33,401 | \$ 7,852,573 | \$ (1,732) | \$ 8,791,067 |

| (Thousands of dollars) | Commercial Real Estate | Corporate and Retail Banking | Intersegment Eliminations | Total Consolidated |
|---|---------------------------|------------------------------------|------------------------------|-----------------------|
| Three months ended September 30, 2006 | | | | |
| Total revenues | \$ 148,861 | \$ 82,664 | \$ (73,512) | \$ 158,013 |
| Net interest income | \$ 70,794 | \$ 19,939 | \$ | \$ 90,733 |
| Provision for loan losses | (12,687) | | | (12,687) |
| Other non-interest income | 4,556 | 269 | | 4,825 |
| Compensation | (8,216) | (16,918) | | (25,134) |
| Occupancy | (791) | (2,488) | | (3,279) |
| Other non-interest expense Allocations | (2,302) | (17,289) | | (19,591) |
| | (1,269) | 1,269 | | |

Edgar Filing: FREMONT GENERAL CORP - Form 10-Q

| | | | |
|--|--------------|-------------|---------------|
| Income (loss) before income taxes | 50,085 | (15,218) | 34,867 |
| Income tax expense | | | (12,190) |
| Income (loss) from continuing operations | 50,085 | (15,218) | 22,677 |
| Income from discontinued operations, net of income taxes | | | 6,848 |
| Net income (loss) | \$ 50,085 | \$ (15,218) | \$ 29,525 |
| Assets continuing operations | \$ 6,009,650 | \$ 885,150 | \$ 6,894,800 |
| Assets discontinued operations | | | 5,907,936 |
| Total consolidated assets | \$ 6,009,650 | \$ 885,150 | \$ 12,802,736 |

24 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

| | Commercial | Corporate and | Intersegment | Total |
|--|-------------|-------------------|--------------|--------------|
| (Thousands of dollars) | Real Estate | Retail Banking | Eliminations | Consolidated |
| Nine months ended September 30, 2007 | | | | |
| Total revenues | \$ 381,492 | \$ 356,323 | \$ (208,328) | \$ 529,487 |
| Net interest income | \$ 155,048 | \$ 12,637 | | \$ 167,685 |
| Provision for loan losses | (333) | | | (333) |
| Other non-interest income | 18,116 | 49,229 | | 67,345 |
| Compensation | (18,353) | (70,460) | | (88,813) |
| Occupancy | (1,200) | (11,745) | | (12,945) |
| Other non-interest expense | 4,546 | (80,687) | | (76,141) |
| Allocations | (3,411) | 3,411 | | |
| Income (loss) before income taxes | 154,413 | (97,615) | | 56,798 |
| Income tax expense | | | | (24,518) |
| Income (loss) from continuing operations | 154,413 | (97,615) | | 32,280 |
| Loss from discontinued operations, net of income taxes | | | | (869,773) |
| Net income (loss) | \$ 154,413 | \$ (97,615) | | \$ (837,493) |
| Assets continuing operations | \$ 33,401 | \$ 7,852,573 | \$ (1,732) | 7,884,242 |
| Assets discontinued operations | | | | 906,825 |
| Total consolidated assets | \$ 33,401 | \$ 7,852,573 | \$ (1,732) | \$ 8,791,067 |
| | Commercial | Corporate and | Intersegment | Total |
| (Thousands of dollars) | Real Estate | Retail Banking | Eliminations | Consolidated |
| Nine months ended September 30, 2006 | | | | |
| Total revenues | \$ 390,661 | \$ 209,186 | \$ (185,515) | \$ 414,332 |
| Net interest income | \$ 194,858 | \$ 50,587 | | \$ 245,445 |
| Provision for loan losses | (28,284) | (4) | | (28,288) |
| Other non-interest income | 10,296 | 833 | | 11,129 |
| Compensation | (21,710) | (55,825) | | (77,535) |
| Occupancy | (2,248) | (7,880) | | (10,128) |
| Other non-interest expense | (1,758) | (47,358) | | (49,116) |
| Allocations | (3,763) | 3,763 | | |

Edgar Filing: FREMONT GENERAL CORP - Form 10-Q

| | | | |
|--|--------------|-------------|---------------|
| Income (loss) before income taxes | 147,391 | (55,884) | 91,507 |
| Income tax expense | | | (34,797) |
| Income (loss) from continuing operations | 147,391 | (55,884) | 56,710 |
| Income from discontinued operations, net of income taxes | | | 56,426 |
| Net income (loss) | \$ 147,391 | \$ (55,884) | \$ 113,136 |
| Assets continuing operations | \$ 6,009,650 | \$ 885,150 | \$ 6,894,800 |
| Assets discontinued operations | | | 5,907,936 |
| Total consolidated assets | \$ 6,009,650 | \$ 885,150 | \$ 12,802,736 |

2007 QUARTERLY REPORT 25

Table of Contents**NOTE 19 EARNINGS PER SHARE**

Earnings per share have been computed based on the weighted-average number of shares. The following tables set forth the computation of basic and diluted earnings per share:

| (In Thousands, except per share amounts) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Income from continuing operations (numerator for basic and diluted earnings per share) | \$ 32,196 | \$ 22,677 | \$ 32,280 | \$ 56,710 |
| Weighted-average shares (denominator for basic earnings per share) | 77,113 | 74,498 | 76,371 | 74,187 |
| Effect of dilutive securities using the treasury stock method for restricted stock and stock options: | | | | |
| Employee benefit plans | 704 | 1,221 | 974 | 1,201 |
| Restricted stock | | 366 | | 406 |
| Stock options | | 16 | | 64 |
| Dilutive potential common shares | 704 | 1,603 | 974 | 1,671 |
| Adjusted weighted-average shares (denominator for diluted earnings per share) | 77,817 | 76,101 | 77,345 | 75,858 |
| Potentially dilutive shares related to restricted stock not included above since they are antidilutive | 915 | | 766 | |
| Basic earnings per share from continuing operations | \$ 0.42 | \$ 0.31 | \$ 0.42 | \$ 0.77 |
| Diluted earnings per share from continuing operations | \$ 0.41 | \$ 0.30 | \$ 0.42 | \$ 0.75 |

For additional disclosures regarding stock options and restricted stock see Note 14.

NOTE 20 SUBSEQUENT EVENTS

On October 23, 2007, Fremont General entered into a Stockholder Rights Plan (the Rights Plan) under which one right was distributed as a dividend for each share of common stock held by stockholders of record as of the close of business on November 2, 2007. The Rights Plan has been adopted as a means to assist in the preservation of the use of previously accumulated net operating losses, as described below.

The Company has net operating losses (NOLs) that may in the future offset the Company's taxable income, if any. U.S. federal income tax law imposes significant limitations on the ability of a corporation to use its NOLs to offset income in circumstances where such corporation has experienced a change in ownership. Generally, there is a change in ownership if, at any time, one or more 5% stockholders have aggregate increases in their ownership in the corporation of more than 50 percentage points looking back over the prior three-year period. One of the principal reasons for adopting the Rights Plan is to dissuade investors from aggregating ownership in the Company and triggering such a change in ownership. The Rights Plan is designed to reduce the likelihood of a change in ownership

by, among other things, discouraging any person or group from acquiring additional shares of the Company's common stock. The Rights Plan was not adopted in response to any effort to acquire control of the Company.

To help preserve the benefit of the NOLs, the Company intends to submit for stockholder approval at its 2008 Annual Meeting an amendment to its articles of incorporation to restrict certain acquisitions of the Company's common stock so as to reduce the likelihood of triggering a change in ownership. The Board of Directors intends to terminate the Rights Plan if such amendment is approved.

Under the Rights Plan, each right initially will entitle stockholders to purchase a fraction of a share of preferred stock at a purchase price of \$12.00, subject to adjustment as provided in the Rights Plan. Subject to the exceptions and limitations contained in the Rights Plan, the rights generally will be exercisable only if a person or group acquires beneficial ownership of 5% or more of the Company's common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 5% or more of the Company's common stock. Unless earlier terminated, the rights will expire on November 2, 2017.

Table of Contents

Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

OVERVIEW

Fremont General Corporation (Fremont General or when combined with its subsidiaries the Company or we or our a holding company which during the first two quarters of 2007 was engaged in lending operations through its indirectly wholly-owned California industrial bank subsidiary, Fremont Investment & Loan (FIL). Fremont General is not a bank holding company as defined for regulatory purposes.

As discussed in more detail in Note 1 of Notes to Consolidated Financial Statements, the Company has withdrawn from the residential real estate business and sold its commercial real estate lending business and outstanding portfolio to iStar Financial Inc. (iStar) on July 2, 2007. In addition, on March 7, 2007, Fremont General, FIL and Fremont General Credit Corporation (FGCC) an intermediate holding company wholly owned by Fremont General, consented to a Cease and Desist Order (the Order) issued by the Federal Deposit Insurance Corporation (FDIC), without admitting to the allegations contained in the Order. The following discussion and analysis of the financial condition and results of operations of the Company is qualified in its entirety by reference to such events.

Prior to the disposal of its commercial and residential real estate lending operations, FIL funded these operations primarily through deposit accounts sourced in California that are insured up to the maximum legal limit by the FDIC and, to a lesser extent, advances from the Federal Home Loan Bank (FHLB) of San Francisco. FIL is regulated by the FDIC and the Department of Financial Institutions of the State of California (DFI). FIL raises its retail deposits in California (predominately Southern California) through a network of 22 branches and a centralized call center.

During the first two quarters of 2007, the Company's commercial real estate operations generated net interest income on the difference between the rates charged on the loans and the cost of borrowed funds. The majority of commercial real estate loans originated were adjustable interest rate loans based upon either one, three and six-month LIBOR and an applicable margin. Upon completion of the sale of the commercial real estate loan portfolio to iStar on July 2, 2007, the Company began recognizing interest income on the \$4.2 billion participation interest received in the commercial loan portfolio at a rate of LIBOR + 150 basis points.

The Company's business is influenced by the overall condition of the economy, in particular the interest rate environment, and various market conditions. As a result, the Company is subject to experiencing volatility in the amount of gain or loss recognized on the sale of its remaining residential real estate loans held for sale, net interest income and earnings.

The principal market risks the Company faces are interest rate risk, liquidity risk and credit risk. Interest rate risk is the risk that the valuation of the Company's interest sensitive assets and liabilities and its net interest income will change due to changes in interest rates. Liquidity risk, which is the ability of the Company to access the necessary funding and capital resources, in a cost-effective manner, to sell its loans held for sale. Liquidity risk also entails the risk of changes in secondary market conditions, which can negatively impact the pricing realized by the Company on the loans it sells. Credit risk is the Company's potential risk of loss due to borrower default, which is impacted not only by specific borrower issues but by macro economic factors such as the supply and demand of housing.

This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and notes thereto presented under Item 1, and the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and the Company's Quarterly Reports on Form 10-Q for the periods ended March 31 and June 30, 2007.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, the Company evaluates its estimates, which are based on historical experience and on various other assumptions that are believed to be reasonable under the

Table of Contents

circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company has identified three accounting policies as being critical because they require more significant judgment and estimates about matters that may differ from the estimates determined under different assumptions or conditions. These critical accounting policies relate to the gain or loss on whole loan sales of residential real estate loans (which is included as part of discontinued operations beginning in the first quarter of 2007), income taxes and discontinued operations. The first two critical accounting policies and estimates are discussed in Management's Discussion and Analysis in the Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

The third critical accounting policy relates to the Company's discontinued operations. As more fully described in Note 1 of Notes to Consolidated Financial Statements, in March 2007, the Company decided to exit the residential real estate business and to sell substantially all of the assets related to such business. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), the Company has classified the residential real estate operations as discontinued operations as the cash flow of the business has been eliminated from our ongoing operations and we will no longer have any significant continuing involvement in the business. Therefore, the results of operations, financial position and cash flows of the Company's residential real estate operations are presented separately in the consolidated financial statements and notes as discontinued operations for all periods presented.

When an operation meets the criteria for held for sale accounting as defined in SFAS No. 144, the operation is evaluated to determine whether the carrying value exceeds its fair value less costs to sell. Any loss resulting from the carrying value exceeding the fair value less costs to sell is recorded in the statement of operations in the period the operation meets the criteria for held for sale accounting. Management judgment is required to both assess the criteria required for held for sale accounting as well as to estimate fair value. Changes in the operation could cause it to no longer qualify for held for sale accounting and changes in fair value could result in an increase or decrease to previously recognized losses. For additional information concerning the Company's discontinued operations see Note 6 of Notes to Consolidated Financial Statements. For additional information regarding the Company's sale of its commercial real estate loan portfolio in July 2007, see Notes 5 and 8 of Notes to Consolidated Financial Statements.

Two changes to the Company's critical accounting policies since December 31, 2006 are the Company no longer considers derivatives and the allowance for loan losses to be critical accounting policies. Due to the Company's exit from the residential real estate business, the Company utilized fewer derivative instruments beginning in the first quarter of 2007. As of the end of the second and third quarters of 2007, the Company no longer had any derivative instruments. In addition, due to the Company's decision to sell the commercial real estate loan portfolio in the first quarter of 2007, the Company reclassified the portfolio from held for investment to held for sale. The Company eliminated the allowance for loan losses and adjusted the carrying value of the loans to their estimated fair value less costs to sell. On July 2, 2007 the Company completed the sale of its \$6.27 billion commercial real estate portfolio to iStar and removed from its balance sheet the total amount of its commercial real estate loans held for sale.

EARNINGS PERFORMANCE

As more fully described in Note 1 of Notes to Consolidated Financial Statements, the Company decided to exit the residential real estate business in March 2007 and the results of that business are now reported as discontinued operations. Therefore, during the nine months ended September 30, 2007 and 2006 the Company's reported earnings from continuing operations are limited to the results from its commercial real estate business and retail banking and corporate operations.

The Company reported income from continuing operations before income taxes of \$53.9 million for the third quarter of 2007 as compared to \$34.9 million for the third quarter of 2006. During the nine months ended September 30, 2007 the Company reported income from continuing operations before income taxes of \$56.8 million as compared to \$91.5 million during the comparable period in 2006. The components of the Company's results of operations are more fully described below.

28 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

Due to the Company's exit from its residential real estate lending operations and sale of its commercial real estate lending business and related loan portfolio as more fully described in Note 1 of Notes to Consolidated Financial Statements, the Company will have a reduced revenue stream for at least the remainder of fiscal year 2007, relying on interest income as its primary source of revenue. The Company expects that it will experience a lower yield on its interest earning assets due to a higher concentration in short term investment grade securities. As a result, the Company expects that it will incur a net loss from continuing operations for at least the remainder of fiscal year 2007.

Net Interest Income

The Company, in connection with its near-term strategic goal of attempting to reduce its risk profile and achieve a steady state of operations, began the process of divesting the sub-prime mortgage loan portfolio and business and its commercial real estate loan portfolio and business during 2007. This reorientation in the operations will necessarily have the effect of lowering both returns and risk profiles simultaneously with regard to the Company's balance sheet mix. The shift in the mix and risk profile of the Company's investment portfolio is deemed to be a necessary step in the Company's transition prior to setting up more permanent, sustainable and diversified asset generating businesses. There can be no assurances that the Company will be able to develop or acquire any such businesses. The following is an outline of the Company's current activities and their impact on net interest income.

Residential real estate loans

Although the whole loan sales of residential real estate loans during the first nine months of 2007 reduced the Company's exposure to credit risk, they also reduced the net interest margin compared to historical results and balance sheet composition.

The Company, between December 31, 2006 and September 30, 2007, reduced its residential real estate loans held for sale by \$4.44 billion to \$511.7 million in connection with its previously announced loan sales. While the Company continues to market its remaining loans held for sale, it does so on a discounted or "scratch and dent" basis due to the nature and marketability of the remaining loans in terms of their delinquency status, aging, valuation profile, and repurchase composition. Yields will be lower because proceeds from loan sales have been reinvested in short term investment grade instruments. As an example, the Company earned \$564.0 million in interest income on \$6.84 billion in residential real estate loans held for sale, or 8.25% during 2006. Reinvestment of these balances is currently being executed at rates that approximate the one month LIBOR index as a result of the lower risk nature of the Company's short term investments.

Commercial real estate loans

The sale of the Company's \$6.27 billion commercial real estate loan portfolio and majority of the non-loan assets used in the business in return for a \$4.2 billion lower yielding LIBOR-based participation interest and \$1.89 billion in cash in July 2007 has enabled the Company to reinvest that money into short term investment grade securities designed to help give the Company maximum flexibility.

Cash and Short term investments

The Company's short term investment portfolio strategy is designed to help preserve liquidity in an effort to provide maximum balance sheet flexibility during the Company's transition period. The Company will attempt to maintain a low credit risk profile and selectively purchase short lockout agency callable notes of short duration or floating rate agency collateralized mortgage obligations to enhance yield relative to other short term investments.

From December 31, 2006 to September 30, 2007, the Company increased its total cash and cash equivalents by approximately \$1.90 billion. The normal deployment of deposits and debt to fund new loan growth was curtailed due to the decision to exit the sub-prime loan origination and commercial real estate loan origination businesses during the first quarter of 2007. The Company's cash position also increased during the period due to the ongoing sale of residential real estate mortgage loans held for sale during

Table of Contents

the first nine months of 2007 and the Company's sale of its commercial real estate lending business and related loan portfolio to iStar on July 2, 2007.

Deposits

The Company's funding needs are a result of the sale of its commercial real estate loans and the substantial reduction of its residential real estate loans as compared to December 31, 2006. Retail deposits were \$7.30 billion at September 30, 2007 with a weighted average interest rate of 4.95% compared to \$8.37 billion at December 31, 2006 with an average interest rate of 5.05%.

Broker Deposits

Broker deposits are continuing to run off based on original maturity. The Company does not expect to replenish broker deposits because the Company is required to seek prior approval from the FDIC to raise additional broker deposits under the Order. The Company's outstanding broker deposits were \$659.9 million and \$1.62 billion as of September 30, 2007 and December 31, 2006, respectively. Assuming no additional broker deposits, this run off will result in less than \$300 million in these deposits outstanding as of December 31, 2007.

Net Interest Income Table

The Company recorded net interest income for the third quarter and nine months ended September 30, 2007 of \$25.1 million and \$167.7 million, respectively, and \$90.7 million and \$245.4 million, respectively, for the comparable periods in 2006.

The following tables identify the consolidated interest income, interest expense, average interest-earning assets and interest-bearing liabilities, and net interest margins, as well as an analysis of changes in net interest income due to volume and rate changes, for the third quarter and first nine months of 2007 and 2006:

| (Thousands of dollars, except percents) | Three Months Ended September 30, | | | | | |
|---|----------------------------------|-------------------|--------------|---------------------|-------------------|--------------|
| | 2007 | | | 2006 | | |
| | Average Balance | Interest | Yield/ Cost | Average Balance | Interest | Yield/ Cost |
| Interest-earning assets⁽¹⁾: | | | | | | |
| Participation interest/Commercial real estate loans | \$ 4,078,203 | \$ 72,131 | 7.02% | \$ 6,059,445 | \$ 144,306 | 9.45% |
| Cash equivalents and investment securities | 3,954,807 | 58,043 | 5.82% | 568,547 | 8,882 | 6.20% |
| Total interest-earning assets | \$ 8,033,010 | \$ 130,174 | 6.43% | \$ 6,627,992 | \$ 153,188 | 9.17% |
| Interest-bearing liabilities: | | | | | | |
| Time deposits | \$ 7,503,513 | \$ 98,783 | 5.22% | \$ 7,865,020 | \$ 99,037 | 5.00% |
| Savings deposits | 1,512,846 | 15,949 | 4.18% | 1,536,547 | 14,667 | 3.79% |
| Senior Notes due 2009 | 166,530 | 3,350 | 8.05% | 168,323 | 3,388 | 8.05% |
| Junior Subordinated Debentures | 103,093 | 2,320 | 9.00% | 103,093 | 2,320 | 9.00% |

Edgar Filing: FREMONT GENERAL CORP - Form 10-Q

| | | | | | | |
|---|--------------|------------|-------|--------------|-----------|-------|
| Interest-bearing liabilities allocated to discontinued operations | (1,049,425) | (15,290) | 5.78% | (3,746,014) | (56,957) | 6.03% |
| Total interest-bearing liabilities | \$ 8,236,557 | \$ 105,112 | 5.06% | \$ 5,926,969 | \$ 62,455 | 4.18% |
| Net interest income | | \$ 25,062 | | | \$ 90,733 | |
| Percent of average interest-earning assets: | | | | | | |
| Interest income | | | 6.43% | | | 9.17% |
| Interest expense | | | 5.19% | | | 3.74% |
| Net interest margin | | | 1.24% | | | 5.43% |

(1) Average loan balances include non-accrual loan balances.

30 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

| (Thousands of dollars) | Three Months Ended September 30, 2007 Compared to 2006 | | |
|---|---|-------------|-------------|
| | Change Due To | | |
| | Volume ⁽¹⁾ | Rate | Total |
| Cash equivalent and investment securities | \$ 49,699 | \$ (538) | \$ 49,161 |
| Participation interest/Commercial real estate loans | (35,042) | (37,133) | (72,175) |
| Increase (decrease) in interest income | 14,657 | (37,671) | (23,014) |
| Time deposits | 4,759 | (4,505) | 254 |
| Savings deposits | 250 | (1,532) | (1,282) |
| Senior Notes due 2009 | 38 | | 38 |
| Junior Subordinated Debentures | | | |
| Interest-bearing liabilities allocated to discontinued operations | (39,289) | (2,378) | (41,667) |
| Increase in interest expense | (34,242) | (8,415) | (42,657) |
| Decrease in net interest income | \$ (19,585) | \$ (46,086) | \$ (65,671) |

⁽¹⁾ Changes in rate/volume are allocated to change in volume.

| (Thousands of dollars, except percents) | Nine Months Ended September 30, | | | | | |
|---|---------------------------------|------------|----------------|-----------------|------------|----------------|
| | 2007 | | | 2006 | | |
| | Average Balance | Interest | Yield/ Cost | Average Balance | Interest | Yield/ Cost |
| Interest-earning assets ⁽¹⁾ : | | | | | | |
| Participation interest/Commercial real estate loans | \$ 5,662,028 | \$ 363,375 | 8.58% | \$ 5,554,367 | \$ 380,365 | 9.16% |
| Cash equivalents and investment securities | 2,288,691 | 98,767 | 5.77% | 586,274 | 22,838 | 5.21% |
| Total interest-earning assets | \$ 7,950,719 | \$ 462,142 | 7.77% | \$ 6,140,641 | \$ 403,203 | 8.78% |
| Interest-bearing liabilities: | | | | | | |
| Time deposits | \$ 8,209,853 | \$ 321,085 | 5.23% | \$ 7,791,367 | \$ 267,873 | 4.60% |
| Savings deposits | 1,652,899 | 53,908 | 4.36% | 1,545,762 | 42,901 | 3.71% |
| Senior Notes due 2009 | 166,530 | 10,051 | 8.05% | 172,137 | 10,398 | 8.05% |
| Junior Subordinated Debentures | 103,093 | 6,959 | 9.00% | 103,093 | 6,959 | 9.00% |

Edgar Filing: FREMONT GENERAL CORP - Form 10-Q

| | | | | | | |
|---|--------------|------------|-------|--------------|------------|-------|
| Interest-bearing liabilities allocated to discontinued operations | (2,231,809) | (97,546) | 5.84% | (4,055,554) | (170,373) | 5.62% |
| Total interest-bearing liabilities | \$ 7,900,566 | \$ 294,457 | 4.98% | \$ 5,556,805 | \$ 157,758 | 3.80% |
| Net interest income | | \$ 167,685 | | | \$ 245,445 | |
| Percent of average interest-earning assets: | | | | | | |
| Interest income | | | 7.77% | | | 8.78% |
| Interest expense | | | 4.95% | | | 3.43% |
| Net interest margin | | | 2.82% | | | 5.35% |

(1) Average loan balances include non-accrual loan balances.

2007 QUARTERLY REPORT 31

Table of Contents

| | Nine Months Ended September 30, 2007 Compared to 2006 | | |
|---|--|-------------|-------------|
| | Change Due To | | |
| (Thousands of dollars) | Volume ⁽¹⁾ | Rate | Total |
| Cash equivalent and investment securities | \$ 73,467 | \$ 2,462 | \$ 75,929 |
| Participation interest/Commercial real estate loans | 6,909 | (23,899) | (16,990) |
| | | | |
| Increase (decrease) in interest income | 80,376 | (21,437) | 58,939 |
| | | | |
| Time deposits | (16,367) | (36,845) | (53,212) |
| Savings deposits | (3,494) | (7,513) | (11,007) |
| Senior Notes due 2009 | 347 | | 347 |
| Junior Subordinated Debentures | | | |
| Interest-bearing liabilities allocated to discontinued operations | (79,711) | 6,884 | (72,827) |
| | | | |
| Increase in interest expense | (99,225) | (37,474) | (136,699) |
| | | | |
| Decrease in net interest income | \$ (18,849) | \$ (58,911) | \$ (77,760) |

⁽¹⁾ Changes in rate/volume are allocated to change in volume.

Non-Interest Income

Total non-interest income increased to \$65.9 million during the third quarter of 2007 from \$4.8 million for the third quarter of 2006. For the nine months ended September 30, 2007, total non-interest income increased to \$67.3 million from \$11.1 million for the comparable period in 2006. For 2007, non-interest income consisted primarily of a one time \$65.6 million gain recognized on the sale of the Company's commercial real estate loan portfolio and related assets to iStar. See Note 8 of Notes to Consolidated Financial Statements for further information concerning the gain on sale of the commercial real estate loan portfolio and related assets.

Non-Interest Expense

Total non-interest expense decreased to \$36.9 million during the third quarter of 2007 from \$48.0 million for the third quarter of 2006.

The decrease in non-interest expense during the third quarter of 2007 was due primarily to a decrease in compensation expense to \$14.4 million from \$25.1 million for the comparable period in 2006. This decrease in compensation expense was due to the reduction in personnel related to the Company's commercial real estate loan origination operations and related support staff.

For the nine months ended September 30, 2007, total non-interest expense increased to \$177.9 million from \$136.8 million for the comparable period in 2006 due to an increase in compensation and other non-interest expense.

During the nine months ended September 30, 2007, compensation expense increased to \$88.8 million from \$77.5 million for the comparable period in 2006. The primary driver of the increase in compensation expense on a year over year basis was a one-time termination cost related to the commercial real estate loan origination operations and related support staff of \$6.3 million.

During the nine months ended September 30, 2007, other non-interest expense increased to \$76.1 million from \$49.1 million for the comparable period in 2006 primarily due to higher legal and professional fees and FDIC and DFI examination fees. Legal and professional fees increased during the period in part due to costs related to compliance with the Order, the sale of the commercial real estate lending business and related loan portfolio to *iStar*, the transaction with Gerald J. Ford (see Note 1 of Notes to Consolidated Financial Statements) and the potential sale of the Company's sub-prime residential loan servicing platform and other assets.

32 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

Other non-interest expense categories for the third quarter and nine months ended September 30, 2007 and 2006 are summarized in the table below.

| (Thousands of dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------------|------------------------------------|------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Legal, professional and other outside services | \$ 11,551 | \$ 7,445 | \$ 33,061 | \$ 18,561 |
| Information technology | 2,142 | 4,520 | 8,714 | 11,944 |
| Printing, supplies and postage | 722 | 1,235 | 2,048 | 3,867 |
| Advertising and promotion | 651 | 1,811 | 3,764 | 5,398 |
| Auto and travel | 536 | 1,285 | 2,479 | 3,589 |
| Leasing and loan | 28 | 252 | 1,368 | 700 |
| Net real estate owned | (4,574) | 176 | (4,325) | (6,791) |
| Telephone | 428 | 617 | 2,028 | 2,019 |
| FDIC and DFI | 6,702 | 383 | 25,438 | 2,370 |
| Other | 1,264 | 1,867 | 1,566 | 7,459 |
| Total other non-interest expense | \$ 19,450 | \$ 19,591 | \$ 76,141 | \$ 49,116 |

Income Taxes

Income tax expense was \$21.7 million on income from continuing operations of \$53.9 million for the third quarter of 2007, compared to income tax expense of \$12.2 million on income from continuing operations of \$34.9 million for the third quarter of 2006.

For the nine months ended September 30, 2007, income tax expense was \$24.5 million on income from continuing operations of \$56.8 million, compared to income tax expense of \$34.8 million on income from continuing operations of \$91.5 million for the comparable period in 2006.

The effective tax rate for 2007 and 2006 is different than the Federal enacted tax rate of 35% due mainly to various apportioned state income tax provisions and for 2007, a \$1.4 million adjustment to deferred taxes.

Discontinued Operations

As more fully described in Note 1 of Notes to Consolidated Financial Statements, in the first quarter of 2007, the Company decided to exit the residential real estate business and to sell substantially all of the assets related to such business. In accordance with accounting principles generally accepted in the United States, income after taxes from discontinued operations and the net loss on disposal of discontinued operations are reported in the consolidated statements of operations after income from continuing operations for all periods presented.

The loss from discontinued operations, net of income taxes, was \$13.9 million for the third quarter of 2007, representing a \$0.18 diluted loss per share, compared to income from discontinued operations, net of income taxes, of \$6.8 million, or \$0.09 diluted income per share for the third quarter of 2006. During the first nine months of 2007, the loss from discontinued operations, net of income taxes, was \$869.8 million, representing a \$11.25 diluted loss per share, compared to income from discontinued operations, net of income taxes, of \$56.4 million, or \$0.74 diluted

income per share for the comparable period in 2006.

In accordance with SFAS No. 128, Earnings per Share, for the three and nine months ended September 30, 2007, the Company calculated the diluted loss per share from discontinued operations, net of income taxes, using the same number of potential common shares used in computing the diluted income per share from continuing operations even though the results were antidilutive with respect to the discontinued operations basic per share amounts.

During the third quarter of 2007, the Company recorded a loss of \$4.1 million, net of valuation reserves, related to the sale of \$234.9 million of residential real estate loans held for sale. During the nine months ended September 30, 2007, the Company recognized a loss of \$881.1 million, net of valuation reserves, related to the sale of \$8.75 billion of residential real estate loans held for sale. Expense provisions related to the residential real estate loan valuation, repurchase and premium recapture reserves are included in this loss. In addition, during the third quarter and first nine months of 2007, the Company recognized \$664,000 and \$39.4 million,

Table of Contents

respectively, in adjustments to write down the carrying value of the residential real estate held for sale assets to their estimated fair value less costs to sell.

During the third quarters of 2007 and 2006, the Company recognized \$8.9 million and \$123.0 million, respectively, in interest income on the residential real estate loan portfolio. During the nine months ended September 30, 2007 and 2006, the Company recognized \$195.4 million and \$396.5 million, respectively, in interest income on the residential real estate loan portfolio.

During the third quarter of 2007, the Company continued to service residential real estate loans, recognizing loan servicing income of \$26.6 million, as compared to \$26.4 million during the third quarter of 2006. During the nine months ended September 30, 2007 and 2006, the Company recognized \$90.3 million and \$71.3 million, respectively, in loan servicing income. The Company was servicing to maturity \$15.38 billion and \$18.12 billion in principal balance of loans as of September 30, 2007 and December 31, 2006, respectively.

The loss from discontinued operations for the three and nine months ended September 30, 2007 includes \$4.8 million and \$10.1 million, respectively, in charges for one time severance payments paid to employees of the residential real estate loan origination operations and related support staff. In addition, during the same periods, the Company recorded \$4.0 million and \$14.7 million, respectively, of charges for lease termination costs related to the Company's residential real estate loan origination offices. For further information concerning the results of operations from the discontinued operations see Note 6 of Notes to Consolidated Financial Statements.

During the nine months ended September 30, 2007, cash flows related to residential real estate loan originations and proceeds realized on the sale of such loans were \$3.89 billion and \$7.81 billion, respectively, and during the nine months ended September 30, 2006, such cash flows were \$25.84 billion and \$25.31 billion, respectively. These amounts are included in cash flows from operating activities in the Company's consolidated statements of cash flows.

REVIEW OF FINANCIAL CONDITION

Cash and Investments

Due to the Company's exit from the residential and commercial real estate loan origination business, as of September 30, 2007, a significant portion of the Company's assets were held in cash and cash equivalents and investments classified as available-for-sale. See Notes 3 and 4 of Notes to Consolidated Financial Statements for additional information concerning the Company's cash and cash equivalents and other investments classified as available-for-sale.

Participation Interest

As more fully described in Note 1 of Notes to Consolidated Financial Statements, on July 2, 2007 the Company completed the sale of its entire \$6.27 billion commercial real estate loan portfolio and majority of the non-loan assets used in the business to iStar, and received cash of \$1.89 billion and a 70% participation interest of \$4.2 billion in the loans sold. As of September 30, 2007, the Company's participation interest in the commercial real estate loan portfolio was \$3.62 billion. See Note 5 of Notes to Consolidated Financial Statements for additional information concerning the activity occurring in the participation interest for the three month period ended September 30, 2007.

Assets and Liabilities of Discontinued Operations

For additional information concerning the Company's assets and liabilities related to its discontinued operations, see Note 6 of Notes to Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

The Company's commercial lending activities were financed primarily through deposit accounts offered by FIL and which are insured by the FDIC. FIL offers certificates of deposit and savings and money market deposit accounts (insured by the FDIC to the legal maximum) through its 22 branches in California. FIL minimizes the costs associated with its deposit operations by not offering traditional checking, safe deposit boxes, ATM

34 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

access and other traditional retail services. Deposits totaled \$7.96 billion as of September 30, 2007 and are summarized as to type as follows:

| (Thousands of dollars, except number of accounts) | Number of Accounts | Deposits |
|---|-----------------------|-------------------------|
| Savings and money market deposit accounts | 36,267 | \$ 1,374,501 |
| Certificates of deposit: | | |
| Retail | 125,434 | 5,926,136 |
| Brokered | 53 | 659,889 |
| Total deposits | 161,754 | \$ 7,960,526 |

During the first six months of 2007, additional financing was available to FIL through advances from the FHLB. FIL's credit line with the FHLB had a maximum financing availability that was based on a percentage of FIL's regulatory assets, to which the actual borrowing capacity was subject to collateralization and certain collateral sublimits and eligibility limitations. In March 2007, following the issuance of the Order and the Company's exit from the residential real estate lending business, the FHLB limited FIL's borrowing capacity to existing outstanding debt of \$3.67 billion. By March 31, 2007, FIL had utilized \$2.30 billion in proceeds from loan sales and \$618.1 million in debt from a warehouse lending facility to reduce the outstanding FHLB debt to \$800.0 million. As of June 30, 2007, outstanding FHLB debt was zero and all pledged collateral was released by the FHLB to FIL. As of September 30, 2007 FIL did not maintain any pledged collateral with the FHLB.

In the first quarter of 2007, FIL pledged eligible commercial real estate loans to the Federal Reserve Bank of San Francisco under the Primary Credit program (the Program). There was no outstanding debt at any time during 2007 under the Program. In June 2007, in anticipation of the iStar Transaction, FIL removed all commercial real estate loans pledged as collateral under the Program. As of September 30, 2007, FIL did not maintain any pledged collateral with the Federal Reserve Bank.

In the first quarter of 2007, in connection with the Company's exit from the residential real estate lending business, FIL mutually terminated two of four existing warehouse financing lines and elected to allow one financing facility to expire. As of March 31, 2007, outstanding debt on the remaining warehouse facility was \$618.0 million. On April 30, 2007 all outstanding debt on this facility was repaid. In June 2007, the remaining warehouse financing facility expired. As of September 30, 2007, FIL did not have any warehouse financing lines.

As of September 30, 2007, the Company's liquidity position was comprised of cash and cash equivalents totaling \$2.66 billion. To ensure that these funds remain a source of short term liquidity the Company currently anticipates that the composition of cash and short term investments will be predominantly invested in cash, cash equivalents and short-term U.S. government and agency securities.

During 2007, the Company's capital position was adversely impacted by the operating losses as further described above. Due to these losses, the potential impact of ongoing restructuring efforts on earnings, the adverse market conditions described above and the terms of the Order, the Company has limited access to capital at this time. The Company has submitted a capital plan to the FDIC as required by the Order.

During 2006 and 2005, FIL had transferred by dividend certain of its residual interests in securitized loans to FGCC. The residual interests at FGCC as of September 30, 2007, had an estimated fair value of \$1.8 million. The purpose of these dividends was to create an additional source of cash flow to Fremont General to the extent of cash received from the residual interests.

There exist certain Federal Income Tax and California Franchise Tax matters pending resolution, of which the Company is not yet able to make a determination of their ultimate liability, if any, but does not believe that the actual outcomes of these matters will adversely impact its liquidity or earnings. It is expected that the final resolution of these matters may take several years.

The Company's ability to access the capital markets is very limited as a result of the factors described herein. If it were able to access capital, it would likely be with disadvantageous conditions and pricing reflecting current factors.

Table of Contents

Fremont General has cash and cash equivalents of \$47.2 million as of September 30, 2007 and no debt maturities until March of 2009.

OFF-BALANCE SHEET ACTIVITIES

Prior to 2007, the Company securitized a certain amount of its residential real estate loans. Securitization was a process of transforming the loans into securities sold to investors. The loans were first sold to a special purpose corporation, which then transferred them to a qualifying special-purpose entity (a QSPE) which was legally isolated from the Company. The QSPE, in turn, issued interest-bearing securities, commonly known as asset-backed securities, that were secured by the future cash flows to be derived from the securitized loans. The QSPE used the proceeds from the issuance of the securities to pay the purchase price of the securitized loans.

The investors and the QSPEs do not have any recourse to the Company if the cash flows generated by the securitized loans are inadequate to service the securities issued by the QSPEs. At the close of each securitization, the Company removed from its balance sheet the carrying value of the loans securitized and added to its balance sheet the estimated fair value of the assets obtained in consideration for the loans which generally included the cash received (net of transaction expenses), retained junior class securities (referred to as residual interests) and mortgage servicing rights.

FORWARD LOOKING STATEMENTS

This report may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements and the currently reported results are based upon our current expectations and beliefs concerning future developments and their potential effects upon us. These statements and our results reported herein are not guarantees of future performance or results and there can be no assurance that actual developments and economic performance will be as anticipated by us. Actual developments and/or results may differ significantly and adversely from our expected or currently reported results as a result of significant risks, uncertainties and factors, often beyond our control (as well as the various assumptions utilized in determining our expectations), and which include, but are not limited to, the following:

the impact of the Company's withdrawal from the sub-prime residential real estate mortgage loan origination business;

the impact of the sale of FIL's commercial real estate lending business and related loan portfolio;

the ability of the Company to enter into or complete any strategic transaction;

the ability of the Company to use its NOLs to reduce future tax payments;

the ability of the Company to enter into new lending businesses;

the variability of general and specific economic conditions and trends, and changes in, and the level of, interest rates;

the impact of competition and pricing environments on deposit products;

the ability to access the necessary capital resources in a cost-effective manner to fund our operations;

our ability to sell our existing residential real estate loans held for sale and the prices obtained for such loans;

our ability to realize the full principal amount of the participation interest in the commercial real estate loan portfolio sold to iStar;

the impact of changes in the commercial real estate markets, in particular the housing market, and changes in the fair values of our assets and loans, including the value of the underlying real estate collateral;

the ability to service, collect and realize the amounts outstanding, and the timing thereof, of loans and foreclosed real estate;

the ability to appropriately estimate an adequate level for the valuation reserve for loans held for sale, the loan repurchase reserve and the premium recapture reserve, as well as the fair value of the retained mortgage servicing rights and residual interests in securitizations;

36 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

changes in various economic and other factors which influence the timing and ultimate realization of the cash flows supporting our estimate of fair value for our residual interests in securitized loans and mortgage servicing rights;

the effect of certain determinations or actions taken by, or the inability to secure regulatory approvals from, the Federal Deposit Insurance Corporation, the Department of Financial Institutions of the State of California or other regulatory bodies on various matters;

the impact of the Order on the Company's ability to conduct its business;

our ability to maintain cash flow, including at the Fremont General level, sufficient for us to meet our debt service and other obligations;

the ability to maintain effective compliance with laws and regulations and control expenses;

the impact and cost of adverse state and federal legislation and regulations, litigation, court decisions and changes in the judicial or regulatory climate;

the impact of changes in federal and state tax laws and interpretations, including tax rate changes, and the effect of any adverse outcomes from the resolution of issues with taxing authorities;

the ability to maintain an effective system of internal and financial disclosure controls, and to identify and remediate any control deficiencies, under the requirements of Section 404 of the Sarbanes-Oxley Act of 2002; and

other events, risks and uncertainties discussed elsewhere in this Form 10-Q and from time to time in our other reports, press releases and filings with the Securities and Exchange Commission.

We undertake no obligation to publicly update such forward-looking statements.

Item 3. *Quantitative And Qualitative Disclosures About Market Risk*

MARKET RISK

The principal market risks the Company faces are interest rate risk, liquidity risk and credit risk. Interest rate risk is the risk that the valuation of the Company's interest sensitive assets and liabilities and its net interest income will change due to changes in interest rates. Liquidity risk, which is the ability of the Company to access the necessary funding and capital resources, in a cost-effective manner, to sell its loans held for sale. Liquidity risk also entails the risk of changes in secondary market conditions, which can negatively impact the pricing realized by the Company on the loans it sells. Credit risk is the Company's potential risk of loss due to borrower default, which is impacted not only by specific borrower issues but by macro economic factors such as the supply and demand of housing.

The Company is subject to market risk resulting primarily from the impact of fluctuations in interest rates upon balance sheet financial instruments such as loans, residual interests, mortgage servicing rights and debt. Changes in interest rates can affect loan interest income, gains or losses on the sale of residential real estate loans, interest expense, net investment income and total stockholders' equity. The level of gain or loss on the sale of residential real estate loans is highly dependent upon the premium paid by the purchasers of such loans. Each of these factors, in turn, are highly dependent upon changes in, and the level of, interest rates and other economic factors. The Company may experience a decrease in the amount of gain it realizes should significant interest rate volatility occur or if other economic factors have a negative impact on the value of the loans. The objective of the asset and liability management

activities is to provide an acceptable level of net interest and investment income and to seek cost effective sources of capital, while maintaining acceptable levels of interest rate and liquidity risk. There is no exposure to foreign currency or commodity price risk.

The Company is subject to interest rate risk resulting from differences between the rates on, and repricing characteristics of, interest-earning loans held for sale and the rates on, and repricing characteristics of, interest-bearing liabilities used to finance these loans such as deposits and debt. Interest rate gaps may arise when assets are funded with liabilities having different repricing intervals or different market indices to which the instruments' interest rate is tied and to this degree, earnings will be sensitive to interest rate changes. Additionally, interest rate gaps could develop between the market rate and the interest rate on loans in the loan portfolio, which could result in borrowers prepaying their loan obligations. The Company attempts to match the characteristics of interest rate sensitive assets and liabilities to minimize the effect of fluctuations in interest rates. For the Company's financial instruments, the expected maturity date does not necessarily

Table of Contents

reflect the net market risk exposure because certain instruments are subject to interest rate changes before expected maturity.

The Company is reliant upon the secondary mortgage market for execution of the whole loan sales of its remaining residential real estate loans held for sale. While the Company strives to maintain adequate levels of liquidity support and capital to withstand certain disruptions in the secondary mortgage market, a significant disruption or change in the level of demand could lead to reduced gains (or higher losses) on sale and a corresponding decrease in revenue and earnings. A deterioration in the performance of the residential real estate loans after being sold in whole loan sales could adversely impact the availability and pricing of future transactions.

Quantitative and qualitative disclosures about the Company's market risk are included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Item 4. *Controls And Procedures*

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of September 30, 2007, the Company evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)). The management of Fremont General is responsible for establishing and maintaining adequate internal controls over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Because of its inherent limitations, internal control over financial reporting may not prevent or detect all error and all fraud. All internal control systems, regardless of how well designed and operated, can only provide reasonable, not absolute, assurance with respect to financial statement preparation and presentation.

The evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective in ensuring that information required to be disclosed by the Company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and is accumulated and communicated to the Company's management, including its CEO and CFO, as appropriate to allow timely decisions regarding required disclosures.

REMEDIATION OF MATERIAL WEAKNESSES

As more fully described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006 under Item 9A. Controls and Procedures, and the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007, as of December 31, 2006, March 31, 2007 and June 30, 2007, the Company did not maintain effective operation of internal control over the application of accounting principles generally accepted in the United States of America, resulting in material adjustments to the Company's preliminary annual consolidated financial statements for the year ended December 31, 2006. In addition, for the same periods, the Company did not maintain effective monitoring controls over the Company's commercial real estate business.

The material weakness as of December 31, 2006, March 31, 2007 and June 30, 2007 related to monitoring controls was isolated to the commercial real estate business. The Company discussed this material weakness with Squar, Milner, Peterson, Miranda & Williamson, LLP, the Company's independent registered public accounting firm, and concluded that this material weakness was fully remediated by the sale of its commercial real estate lending business and related \$6.27 billion loan portfolio in the third quarter of 2007.

The Company also fully remediated the material weakness related to the misapplication of subsequent event accounting literature, as management increased training and education related to proper accounting treatment for subsequent events. This was completed in the third quarter of 2007.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

Except as otherwise discussed herein, there have been no changes in the Company's internal controls over financial reporting that have occurred since the beginning of the third fiscal quarter of 2007 that have materially affected, or are reasonably likely to material affect, the Company's internal controls over financial reporting.

Table of Contents**PART II OTHER INFORMATION***Item 1. Legal Proceedings*

The Company is a defendant in a number of legal actions or regulatory proceedings arising in the ordinary course of business, from the discontinuance of the insurance operations and from regulatory examinations conducted by the FDIC and the DFI.

The following is a material legal proceeding filed during the third quarter of 2007 not previously reported. For further information concerning material pending and threatened litigation action and proceedings against the Company, see Part I. Item 3. Legal Proceedings, in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Morgan Stanley v. Fremont Investment & Loan:

On October 23, 2007, Morgan Stanley Mortgage Capital Holdings LLC filed a lawsuit in the United States District Court for the Southern District of New York against FIL alleging breaches with respect to residential mortgage loans it sold to Morgan Stanley between May 1, 2005 and December 28, 2006. The complaint alleges damages of at least \$10 million. The case is in its very early stages and the Company cannot predict the outcome or effect it will have on its financial condition. However, the Company believes the lawsuit is without merit and will vigorously defend against it.

Item 1A. Risk Factors

We included a discussion of our Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006. There has been no material change in such risks during the nine months ended September 30, 2007.

*Item 2. Unregistered Sales of Equity Securities and Use of Proceeds***ISSUER PURCHASES OF EQUITY SECURITIES**

| Period | (a) Total Number of Shares (or Units) Purchased ⁽¹⁾ | (b) Average Price Paid per Share (or Unit) ⁽²⁾ | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs ⁽³⁾ |
|----------------------|--|--|---|--|
| July 1-31, 2007 | 5,542 | \$ 10.32 | 5,542 | |
| August 1-31, 2007 | 5,015 | \$ 4.65 | 5,015 | |
| September 1-30, 2007 | 763 | \$ 5.31 | 763 | |
| TOTAL | 11,320 | \$ 7.47 | 11,320 | 1,414,308 |
| (1) | | | | |

Shares of common stock acquired by the Company through purchases of shares from participants under certain employee benefit plans at fair value.

- (2) The average price per share was \$7.47 for the three months ended September 30, 2007.
- (3) A repurchase program for four million shares was announced to the public on February 27, 2003, and a repurchase program for an additional four million shares was announced to the public on May 19, 2005.

Table of ContentsItem 6. *Exhibits***Exhibit No. Description**

- 2.1 Asset Purchase Agreement, dated as of May 21, 2007, between Fremont Investment & Loan and iStar Financial Inc. (Incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on May 24, 2007, Commission File Number 001-08007)
- 3.1 Restated Articles of Incorporation of Fremont General Corporation. (Incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q, for the period ended June 30, 1998, Commission File Number 001-08007)
- 3.2 Certificate of Amendment of Articles of Incorporation of Fremont General Corporation. (Incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1998, Commission File Number 001-08007)
- 3.3(a) Amended and Restated By-Laws of Fremont General Corporation. (Incorporated by reference to Exhibit 3.3 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1995, Commission File Number 001-08007)
- 3.3(b) Fremont General Corporation Bylaw Amendment Adopted by the Board of Directors on November 20, 2003. (Incorporated by reference to Exhibit 3.3(b) to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 2003, Commission File Number 001-08007)
- 3.3(c) Fremont General Corporation Bylaw Amendment Adopted by the Board of Directors on March 16, 2004. (Incorporated by reference to Exhibit 3.3(c) to the Registrant's Quarterly Report on Form 10-Q, for the period ended June 30, 2004, Commission File Number 001-08007)
- 3.3(d) Fremont General Corporation Bylaw Amendment Adopted by the Board of Directors on October 22, 2007. (Incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 23, 2007)
- 4.1 Form of Stock Certificate for Common Stock of the Registrant. (Incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 2000, Commission File Number 001-08007)
- 4.2 Rights Agreement, dated as of October 23, 2007, by and between the Company and Mellon Investor Services LLC. (Incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 24, 2007)
- 4.3 Indenture with respect to the 9% Junior Subordinated Debentures among the Registrant, the Trust and Bank of New York (originated with First Interstate Bank of California), a New York Banking Corporation, as trustee. (Incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1995, Commission File Number 001-08007)
- 4.4 Amended and Restated Declaration of Trust with respect to the 9% Trust Originated Preferred Securities among the Registrant, the Regular Trustees, Bank of New York, a Delaware banking corporation, as Delaware trustee, and Bank of New York, N.A., a national banking association, as Institutional Trustee. (Incorporated by reference to Exhibit 4.5 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1995, Commission File Number 001-08007)
- 4.5 Preferred Securities Guarantee Agreement between the Registrant and Bank of New York, N.A., a national banking association, as Preferred Guarantee Trustee. (Incorporated by reference to Exhibit 4.6 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1995, Commission File Number 001-08007)
- 4.6 Common Securities Guarantee Agreement by the Registrant. (Incorporated by reference to Exhibit 4.7 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1995, Commission File Number 001-08007)

Edgar Filing: FREMONT GENERAL CORP - Form 10-Q

- 4.7 Form of Preferred Securities. (Included in Exhibit 4.5). (Incorporated by reference to Exhibit 4.8 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1995, Commission File Number 001-08007)
- 4.8 Indenture dated as of March 1, 1999 between the Registrant and JP Morgan Chase Bank (originated as The first National Bank of Chicago), as trustee. (Incorporated by reference to Exhibit 4.9 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1998, Commission File Number 001-08007)
- 4.9 Registration Rights Agreement among the Registrant and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse First Boston Corporation, Goldman, Sachs & Co., and Warburg Dillon Read LLC (Incorporated by reference to Exhibit 4.10 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1998, Commission File Number 001-08007)

40 FREMONT GENERAL CORPORATION AND SUBSIDIARIES

Table of Contents

| Exhibit No. | Description |
|--------------------|---|
| 4.10 | Form of Fremont General Corporation 7.875% Senior Notes due 2009. (Incorporated by reference to Exhibit 4.11 to the Registrant's Annual Report on Form 10-K, for the fiscal year ended December 31, 1998, Commission File Number 001-08007) |
| 4.11 | Form of Restricted Stock Agreement. (Incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-8 filed on May 18, 2006, Registration Number 333-134236) |
| 4.12 | Form of Nonqualified Stock Option Agreement. (Incorporated by reference to Exhibit 4.3 to the Registrant's Registration Statement on Form S-8 filed on May 18, 2006, Registration Number 333-134236) |
| 10.1(a)* | Letter Agreement between the Registrant and Alan W. Faigin dated April 2, 2007. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 28, 2007, Commission File Number 001-08007) |
| 10.1(b)* | Letter Agreement Amendment between the Registrant and Alan W. Faigin dated August 27, 2007. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 28, 2007, Commission File Number 001-08007) |
| 10.2(a)* | Management Continuity Agreement among the Registrant, Fremont Investment & Loan and Ronald J. Nicolas, Jr. dated April 3, 2007. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 12, 2007, Commission File Number 001-08007) |
| 10.2(b)* | Letter Agreement between Fremont Investment & Loan and Ronald J. Nicolas, Jr. dated April 3, 2007. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on July 12, 2007, Commission File Number 001-08007) |
| 10.2(c)* | Letter Agreement between the Registrant and Ronald J. Nicolas, Jr. dated August 27, 2007. (Incorporate by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on August 28, 2007, Commission File Number 001-08007) |
| 31.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Management or compensatory plans or arrangements. With respect to long-term debt instruments, the Registrant undertakes to provide copies of such agreements upon request by the Commission.

Table of Contents

SIGNATURES

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

FREMONT GENERAL CORPORATION

Date: November 8, 2007

/s/ LOUIS J. RAMPINO

Louis J. Rampino
President and Chief Executive Officer

Date: November 8, 2007

/s/ RONALD J. NICOLAS, JR.
Ronald J. Nicolas, Jr.
*Senior Vice President, Chief Financial Officer
Chief Accounting Officer and Treasurer
(Principal Accounting Officer)*

S-1 FREMONT GENERAL CORPORATION AND SUBSIDIARIES