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Citigroup Q3 2007 Earnings Call Transcript

Citigroup, Inc. (C)

Q3 2007 Earnings Call

October 15, 20078:30 am ET

Executives

Art Tildesley - IR

Charles Prince - Chairman, CEO

Gary Crittenden - CFO

Analysts

Jason Goldberg - Lehman Brothers

Betsy Graseck - Morgan Stanley

Guy Moszkowski - Merrill Lynch

Glenn Schorr - UBS

John McDonald - Banc of AmericaSecurities

Ron Mandle - GIC

Mike Mayo - Deutsche Bank

Meredith Whitney - CIBC World Markets

Jeff Harte - Sandler O'Neill

Vivek Juneja – JP Morgan

Diane Merdian - KBW

Operator

Welcome to Citi's third quarter 2007 earnings reviewfeaturing Citi Chairman and Chief Executive Officer Charles Prince and ChiefFinancial Officer Gary Crittenden. Today's call will be hosted by ArtTildesley, Director of Investor Relations. (Operator Instructions) Mr.Tildesley, you may begin.

Art Tildesley

Thank you very much, operator and thank you all for joiningus today for our third quarter 2007 earnings presentation. We are going to walkyou through a presentation, that presentation is available on our website now,so if you haven't downloaded that, you want to do that now.

The format we will follow will be Chuck will start the call,Gary will take you through our presentationand then we would be happy to answer any questions you may have.

Before we get started, I would like to remind you thattoday's presentation may contain forward-looking statements. Citigroup'sfinancial results may differ materially from these statements, so please referto our SEC filings for a description of the factors that could cause our actualresults to differ from expectations.

With that said, let me turn it over to Chuck.

Charles Prince

Art, thanks very much and good morning to everybody. Thanksfor joining our call this morning. As Art indicated, I'm going to start with afew minutes of discussion on our performance this quarter, both the coreperformance in certain of our businesses that we pre-announced a couple weeksago, as well as the very good performance in some of our businesses. Then I'mgoing to turn it over to Gary totake you through the detailed presentation; then as always, we will be happy toanswer questions.

Before I get started, I would like to comment briefly on ourThursday organizational announcement. I hope all of you saw that we are forminga new business segment. We're going to call it the Institutional Clients Group.By combining our Markets & Banking business and our Alternative Investmentsbusiness under one leadership team. We have asked Vikram Pandit to lead thisnew group. I believe everybody knows Vikram pretty well and his background, hisvery significant accomplishments. In this newly formed group, we will continueto have Michael Klein doing his good job as Chairman and Co-CEO of Markets& Banking. We have promoted Jamie Forese , who has done a very good jobrunning Equities the last few years and has a long history in Fixed Income, tobe Co-CEO of Markets & Banking with Michael. John Havens will be thePresident and Chief Executive Officer of Citi Alternative Investments.

I think these changes are going to be very positive for us.There are obvious overlaps between these two businesses and this new structurewill enhance our ability to serve institutional clients both across the entirecapital market spectrum and around the world. We are looking forward to realprogress in moving capital between these two businesses, and in growing andretaining our clients, and attracting good talent on The Street.

With that said, let me turn to the quarter's results. As wepre-announced two weeks ago, the writedowns and losses in our fixed incomebusiness and the higher credit costs in our Global Consumer business drove asignificant earnings decline. Some of the writedowns and losses in Fixed Incomewere because we have been one of the largest providers of leveraged financingand mortgage-related structured products to clients around the world. Whenthose markets severely dislocated, we obviously suffered losses.

However, some of our losses in Structured Credit and CreditTrading were greater than would have been expected from that market dislocationand simply reflect poor performance. In the context of our strong track recordin these businesses going back over many, many, many years, I would say thisquarter's performance was well below our expectations and frankly, surprising.We are focused on improving these areas. We are working very hard on makingsure that our return to strong performance is something we can be confident in,in these traditional areas. Garywill discuss some of the actions we are taking.

I do you want to say a word about risk management in thiscontext. We have a very strong risk management infrastructure at Citi, and thelosses this quarter in Fixed Income were within the range of potential outcomes,but obviously at the very far end of that range as they relate to our risklimits. We look at these risk practices all the time and we are going toincorporate this summer's experience into that as we go forward.

Let me just switch to consumer credit for a second. As wesaid on our second quarter earnings call, the consumer credit environment is achallenging one, especially here in the U.S.,and we expect meaningful increases in credit costs. This quarter that playedout. Credit costs in consumer increased over $2.8 billion as we built both loanloss reserves and had a meaningful increase in net credit losses. Garywill take you through the drivers of this increase in great detail later in thepresentation.

Now at the same time as we had this poor performance inthese various businesses, I do want to touch on a couple of areas where wecontinue to have strong performance, and strong performance that continues thetrend we saw beginning in the fourth quarter of '06 and continuing in the firstand especially in the second quarter of '07.

In Securities and Banking, we had many businesses performwell. Equity markets, equity underwriting up significantly. Advisory revenuesup significantly. Even in the Fixed Income markets we discussed earlier,several product areas performed well. For example, municipals, interest ratetrading and currency trading.

Our Global Transaction Services business generated anotherquarter of strong growth and record results. In our international Markets &Banking businesses in Asia, Latin America,and Mexico, weagain generated record revenues and double-digit net income growth. Our GlobalWealth Management business also had a very strong quarter, with record revenues,and that is even before adding the benefit from the Nikko Cordial acquisition.

Also in the international space, our international consumerbusiness continues to do very, very, very well with both revenues and businessvolumes growing at a strong double-digit pace. This reflects our strategy withboth organic growth and our recent acquisitions pulling forward very strongly.

In our U.S.consumer business, while the market dislocation that affected our fixed incomebusiness affected certain aspects of the revenue generation of this business,which Gary will get into, theunderlying business momentum that we have seen over the last few quarterscontinues to be very good. Deposits were up 16%. loans up 8%. So as I have saidright along, I'm cautiously optimistic about our U.S.consumer business, and I would say the third quarter reinforces that. I stillfeel good about that business momentum.

In addition to the operating results, we also announced orclosed several important transactions during the quarter. We recently announcedour intention to make Nikko Cordial a fully-owned subsidiary in Japanvia a stock exchange. The Nikkotransaction is a very good one, something I am proud of and something where wecan show how we combine with strong, local institutions to grow ourinternational franchise.

In August, we closed the acquisition of The BISYS Group,which increases our footprint in the high growth prime brokerage and securitiesprocessing area. We recently completed the acquisition of ATD, making us atop-tier electronic market maker and liquidity provider to institutional andretail clients.

So with that overview, let me just wrap up. This quarter'sresults were well below our expectations and as Garywill describe, we are working very hard on the areas that need improvement. Atthe same time, the underlying momentum across many of our businesses continuesvery strong. Execution on our strategic priorities continues and we are verywell positioned to grow these businesses and especially to grow ourinternational franchises.

With that as an overview, Gary,let me turn it over to you.

Gary Crittenden

Thank you, Chuck and good morning to everyone. Thank you forjoining us this morning. Let me turn to the slides that are available to you onour website. Slide 1 shows you our consolidated results for the quarter versusthe third quarter of 2006. To summarize our third quarter results, net revenuesgrew 6% on strong underlying volume growth, partially offset by losses in FixedIncome and writedowns in leveraged lending. Expenses were up 22%. The cost ofcredit was up 139%, driven primarily by a substantial charge to increased loanloss reserves and higher net credit losses in our global consumer businesses.Pre-tax income was down 59%. Net income and EPS were down 57%; and our returnon equity was 7.4%.

Turning to slide 2, it shows five items which significantlyimpact the results for the quarter. First, we took a $1.352 billion writedownin our highly leveraged finance portfolio. Second, we took writedowns in thevalue of our mortgage-backed securities and leveraged loans which werewarehoused for future CDO or CLO securitizations, as well as on CDO positionsof $1.561 billion, net of any hedges. This number is higher by approximately$250 million from the time of our October 1 announcement, due to a refinementof our calculations as we went through the quarter-end closing process.

Third, in credit trading we suffered a $636 million loss asmany of the historical relationships which form the basis for trading decisionsin this business were disrupted.

Fourth, we had a $729 million pretax benefit ininternational card revenues from a partial sale of the shares that we own inRedecard.

Finally, we had a $2.847 billion higher credit cost in our globalconsumer business. This number is higher by approximately $250 million from thefigure which we disclosed in our October 1 announcement. The increase is drivenby higher charges to loan loss reserves, reflecting accelerating delinquenciesin September in our U.S.mortgage portfolio, and a finalization of our estimates during the quarter-endclosing process.

Turning now to slide 3, this shows a five-quarter trend of someof the key drivers in our business. Strong momentum continued across thesedrivers, especially in our international franchises, which drove revenues up by30%, including the impact of acquisitions and the Redecard gain.

Drivers of net interest revenue showed strong growth.Consumer loans were up 8% in the U.S.and 29% internationally. Internationally, organic consumer loan growth was 16%.Corporate loans were up 22%. Consumer deposits were up 16% in the U.S.and 18% internationally. Internationally, organic deposit growth was 8%.

Drivers of non-interest revenues also grew nicely. Creditcard purchase sales were up 6% in the U.S.and 37% internationally. Internationally, organic card purchase sales growthwas 22%. Investment assets under management were up 28% in internationalconsumer. Client assets under management in CAI were up 50%. In our GlobalWealth Management business, assets under fee-based management grew 38% or 20%organically.

In Investment Banking, we ranked number 1 in global debt underwriting, number 3 in announced and completed M&A andnumber 2 in globalequity underwriting on a year-to-date basis.

Now slide 4 shows third quarter year-over-year revenuegrowth in each of our major businesses on the top half. The graph at the bottomof the page shows the year-to-date growth. In looking at the top half of thepage, in U.S. consumer revenue growth was flat, primarily driven by the absenceof a prior-year gain from the sale of mortgage-backed securities, a writedownin the valuation of the residual interest related to the securitizationactivities, combined with lower securitization gains on lower-yielding assetsin our U.S. Cards business.

Markets & Banking revenues reflected the writedowns andlosses that I have mentioned already. Alternative Investments revenues werelower, reflecting lower hedge fund activities; the absence of a prior-year gainfrom the sale of MetLife shares; and changes in the market value of the LeggMason shares.

Offsetting these results was organic revenue growth ininternational consumer and global wealth management, driven by both organicgrowth and acquisitions. U.S.revenues were down 12% and international revenues were up 30%. Acquisitionsaccounted for 5% of the year-over-year revenue growth and business as usualactivities accounted for 1%.

Year-to-date revenue growth trends are strong, despite thesevere market dislocations in the third quarter. We are pleased to see that therelative growth rates of our businesses -- Markets & Banking, InternationalConsumer, and Global Wealth Management -- all grew revenues at double-digitrates. In total, our international revenues grew 27% and our U.S.revenues grew 2%, as we continue to reweight Citi to the higher-growthopportunities. Acquisitions accountedfor 3% of the year-to-date revenue growth. Business as usual activitiesaccounted for 11%.

The bar graph on slide 5 shows the nine quarter sequentialtrend of the change in net interest revenue. The table at the bottom shows youthe net interest margin for the entire company for those same nine quarters. AsI mentioned earlier, we have had strong volume growth in all of our businesses,which has resulted in a fairly steady improvement in the net interest revenueover the last four quarters. As the table at the bottom of the page shows, netinterest margin declined by 3 basis points sequentially. If you exclude thegrey zone impact from both periods, net interest margin decreased by 1 basispoint sequentially.

Slide 6 shows the trend of our expense growth. Weanticipated that this quarter's expense growth comparison would be challenging.If you look at the chart, expenses in the third quarter of 2006 were the lowestin the last seven quarters, primarily reflecting reductions in advertising andmarketing spend in U.S.consumer, and lower expenses in Markets & Banking. The best way to trackour progress on expense management would be to track headcount growth andexpense growth relative to revenues. On both structural expense saves and totalheadcount reductions, we are ahead of our commitments.

Our reported expense growth is 22% and 14% without acquisitions;Nikko was the main driver. Ourbusiness as usual expense growth of 14% is driven by higher business volumesthroughout the franchise and the opening of more than 600 De Novo branches inthe last 12 months. Sequentially, expenses were down, primarily on lowercompensation cost in securities and banking.

Slide 7 shows the trend in headcount growth. Although thegraph indicates significant year-on-year growth, this was driven predominantlyby acquisitions, which contributed 11 percentage points of the 16%year-over-year growth. Excluding acquisitions, from the first quarter of 2006to the first quarter of 2007 headcount grew by 9%. From the second quarter of2006 to the second quarter of 2007, headcount grew by 5%. This quarter we had5% headcount growth, which includes 2 percentage points caused by De Novobranch openings. The sequential headcount growth rate is 3%, with approximatelyhalf from acquisitions and half from business as usual activities. We continueto be heavily engaged in ongoing re-engineering efforts and are focused onexpense management driving results for the next year.

Turning now to slide 8, we discuss credit. It shows theyear-over-year growth components in our total cost of credit and the keydrivers within each component. The total cost of credit increased by $3billion, with $780 million -- or approximately one-quarter of the increase -- drivenby higher net credit losses, and $2.2 billion -- or three-quarters -- driven byhigher charges to increase loan loss reserves.

Higher net credit losses of $780 million were drivenprimarily by our global consumer business. In consumer, NCLs increased by $736million, driven primarily by higher balances from organic portfolio growth andacquisitions, continued deterioration in mortgages and in unsecured personalloans in the US,and in international cards and Japanconsumer finance. This quarter's increase in loan loss reserves was drivenprimarily by the increase in global consumer reserves of $2.1 billion.

The global consumer increase can be split into twocategories: the first contributing approximately 40% of the increase and thesecond contributing approximately 60% of the total. The first category, whichaccounts for approximately 40% of the build, includes, for example, a creditcard customer who is currently in paying status with us but may increase hisbalance on a card, or for the first time start to use the card to take cashadvances. These behavioral patterns can be correlated with future delinquencyand future losses. Our reserve build this quarter reflects such observedbehavioral patterns in our portfolio as an enhancement to our loss estimationprocess. The reserves we built in U.S.cards last quarter and the builds in our remaining consumer businesses thisquarter completes this particular review of our global consumer business.

The second category accounts for approximately 60% of thebuild. Over half of this approximately 60% build is driven by leadingindicators which point to a continued deterioration in credit in certainportfolios, such as in U.S.consumer mortgages and certain macroeconomic indicators. Less than half isdriven by growth and seasoning in the portfolio and acquisitions.

Looking ahead, our reserve balance will always reflect thetypes of considerations I have just described. Markets & Banking creditlosses increased $98 million, primarily reflecting higher net credit losses anda $123 million charge to increase loan loss reserves for specificcounterparties. Credit costs reflected a slight weakening in portfolio creditquality.

The top half of slide 9 shows consumer credit net losses andloan loss reserves as a percentage of loans. The bottom two graphs show 90-daydelinquency rates for our first and second mortgage portfolios in consumerlending. The top graph demonstrates that loan loss reserves and NCLs as apercentage of the consumer loan portfolio have held steady. Excluding theimpact of grey zone, the ratio of NCLs to average loans has been fairly stableexcluding last quarter.

As a reminder, last quarter's 13 basis point sequentialdecline in the NCL ratio was driven by a number of acquisitions that closedduring that quarter. When impaired loans are acquired, they are booked on ourbalance sheet at their estimated net realizable value, which results in lowerNCLs in the early months following the close of a transaction.

Loan loss reserves as a percentage of loans are highersequentially, but in line with levels of two years ago and below the peak inthe first quarter of 2004. Since that peak, the ratio has consistently declineduntil the first quarter of this year, when we started to see it tick up. Thedeclines were a reflection of a particularly favorable credit environment overthe last couple of years. The increase now is a reflection of the currentenvironment and the factors I described above, all of which warranted theaddition to our reserve levels.

The two graphs at the bottom show the 90-plus-daydelinquencies in our first and second mortgage portfolio in the consumer lendinggroup, which have increased substantially, particularly in the month ofSeptember. The first mortgage delinquency trend shows that the currentdelinquency levels are still running below their 2003 peak. In contrast,delinquency rates in our second mortgage portfolio are at historically highlevels. In part, our reserve action for our mortgage portfolio reflects thissignificant deterioration.

Since the beginning of this year, we had added over 1,700collectors and recovery staff in our U.S.consumer businesses, of which over 560 were for mortgages in U.S.consumer lending. We continue to take deliberate actions to lower the volume ofsecond mortgage originations through channels that have historicallydemonstrated a higher incidence of delinquencies, such as third-partycorrespondents. The shift in origination channels, along with tightenedunderwriting criteria, have resulted in an improvement in the quality oforiginations whereby loans originated in this quarter had higher FICO scoresand lower loan-to-values, on average, than those originated a year ago.

In addition to restricting the channels of originations, wehave eliminated a number of product offerings. For example, we no longer offermortgage loans for investment properties or three to four-family homes.

A word on resets. In our consumer lending first mortgageportfolio, approximately $1.7 billion, or 2%, of our adjustable -rate mortgagesare scheduled to reset in the fourth quarter. Approximately $10 billion arescheduled to reset through the end of 2008, compared to $1 trillion of resetsin the U.S.consumer mortgage market. Approximately 90% of our resets have been projectedto be in the higher FICO, lower loan-to-value categories.

Slide 10 shows a historical trend of a number of key capitalratios and return on common equity for the quarter. As the graph shows, all ofour capital ratios have declined since the beginning of the year, drivenprimarily by acquisitions which we have completed and organic acquisitiongrowth.

As we have said before, we target to keep our Tier 1 capitalratio above 7.5% and the total common equity to risk-weighted managed assetratio above the 6.5% level. Both the Tier 1 capital ratio and the TCE torisk-weighted managed assets ratio reflect the impact of acquisitions andadditional assets, such as certain leveraged loans and commercial paper whichcame onto our balance sheet during the quarter. Although at this time there isa lot of variability around the factors that impact our capital ratios, weexpect that we will return to our targeted capital ratio sometime early in2008.

We expect to restore our capital ratios in a number ofdifferent ways. First, we are using stock as opposed to cash as considerationfor the purchase of the remaining 32% of Nikkoin a share-for-share exchange. Second, we are focused on pursuing a disciplinedapproach to growing our balance sheet and deploying capital to the highestgrowth and return opportunities. You may have seen our announcement a few weeksago to centralize our treasury operations.

Finally, organic earnings growth andearnings from our acquisitions will continue to generate capital for the company.We anticipate, however, no further buybacks until we have reached our targetedcapital ratios.

Now I will briefly take you through the results of each ofour major business lines. Slide 11 shows results in our U.S.consumer business. Revenues were flat versus last year's third quarter. Goodvolume growth from our strategic actions was offset by three factors: first,the absence of a $133 million gain from the sale of mortgage-backed securitiesin the third quarter of 2006.

Second, we had a downward adjustment in the valuation of theresidual interest that we hold on our credit card securitizations which getsmarked to market. This was driven primarily by an expectation of continueddeterioration in consumer credit, combined with an increase in short-termfunding costs as commercial paper spreads widened significantly during thequarter, partially offset by the decrease in Fed funds in mid-September.

Third, the receivables securitized this quarter were ofhigher credit quality and had lower yields than those securitized in lastyear's third quarter, resulting in lower securitization revenues in the currentquarter.

Expenses in U.S.consumer grew by 8%, driven by a significant reduction in marketing andadvertising expenses in our cards business in last year's third quarter, aswell as the impact of integrating the ABN AMRO acquisition this quarter intoour consumer lending group. Credit costs increased by $1.7 billion, driven bythe factors that I discussed earlier. A significant reduction in net income isreflective of the challenging market conditions and year-over-year comparisons,combined with the additions to our loan loss reserve.

Slide 12 shows the results of our international consumerbusiness, which have been affected significantly by the results in Japanconsumer finance. Let me start with the impact of the grey zone this quarter.We had a loss in Japanconsumer finance this quarter of $288 million, driven by three primary factors:

First, revenues were lower by 52%, driven by lowerreceivable balances and increased charges to reserves as estimates for lossesfor refund claims increased.

Second, expenses increased 67%, driven by writedowns of $152million pre-tax on customer intangibles and fixed assets. This charge is beingtaken because we have concluded that the carrying value of these specificassets is not recoverable. Excluding these write-downs, expenses in Japanconsumer finance are down approximately one-third from last year's levels as wecontinue to reposition the business.

Third, credit costs increased 25% on higher NCLs and areserve build of $161 million to reflect our expectation of higher lossesinherent in the portfolio.

In this business, the situation remains difficult; and givenour recent experience with the level of grey zone related refund claims, ourbest estimate now is that the business will have net losses in 2007. Wecontinue to analyze the profitability prospects for this business thereafter.

Now let's put Japanconsumer finance aside and look at the results. As you can see from the middlesection of the slide, excluding Japanconsumer finance, international consumer revenues were up 47%; pre-tax incomeis up 30%; net income is up 17% as the absence of prior-year tax benefitscaused a 13 percentage point negative impact on net income growth.

Revenues for this quarter included a $729 million benefitfrom the sale of Redecard shares. Excluding the Redecard gain and Japanconsumer finance, international consumer revenues were up 31%.

A quick word on Redecard. Redecard is the only merchantacquiring company for MasterCard in Brazil.Prior to the July 2007 Redecard IPO, Citigroup was a 31.9% shareholder. We solda portion of our Redecard shares for a pre-tax gain of $729 million and anafter-tax gain of $469 million which is recorded in our international cardresults. Citi continues to hold a 23.95% investment interest in Redecard.

International cards averaged net receivables grew 52%,reflecting strong organic growth and the impact of acquisitions. We launchedfive new partnerships in the quarter, including AirAsia in Malaysiaand Shell in the UK.We now have 189 partnerships in 44 countries and continue to expand thepartnership program.

Retail banking revenues were up 26% driven by strong loan,deposit and investment product sales growth. However, continued investmentspending, higher credit costs reflecting the impact of portfolio sales, and areserve release in last year's third quarter and reserve builds this quarterand lower tax benefits this quarter drove net income down 21%.

Outside of Japan,consumer finance receivables were up 20% and revenues were up 22%.International consumer expense growth excluding Japanconsumer finance reflected the acquisitions that closed during the year andcontinued investment in our distribution network. We opened or acquired 392retail bank branches and 212 consumer finance branches in the last 12 months.

In Japanconsumer finance, credit conditions continue to deteriorate. Outside Japan,credit costs were up $1 billion reflecting increased estimates of lossesinherent in the portfolio, results from acquisitions, organic portfolio growth,and seasoning and the absence of prior year's net releases of $93 million in internationalretail banking. For the total business, the net impact of grey zone and highercredit costs were the primary drivers of a 15% decline in net income.

Slide 13 shows the results in our Markets & Bankingbusiness. The impact of the severe market dislocations resulted in a revenuedecline of 24% and a net income decline of 74%. There were three major driversof the revenue decline:

First, $1.4 billion came from highly-leveraged loan writedowns,of which $901 million was taken against our debt underwriting revenues and $451million against lending revenues.

Second, $1.6 billion from writedowns in mortgage-backedsecurities which were warehoused for future CDO or CLO securitizations as wellas on CDO positions. Our sub-prime exposure related to these positions was $24billion at the beginning of the year, $13 billion at the end of the secondquarter, and declined slightly during the third quarter.

Third, $636 million from losses in credit trading. A majorfactor driving the magnitude of our losses and writedowns is that we are amajor player in the markets that were hardest hit by the dislocation. We havehistorically been a top underwriter of leveraged finance and a leader in thestructured credit and credit trading businesses. That said, as Chuck mentioned,there is no question that we underperformed certain competitors evenconsidering turbulent market conditions. We must examine the situation, learnlessons from it, and make changes.

To give you a sense of some of the things we are working on:

First, we have reorganized credit trading and have changedthe leadership of this business.

Second, in our structured credit business, CLO and CDOstructuring volumes have dropped significant and we are diversifying ourbusiness more towards trading, where we have traditionally had a strong marketposition.

Third, in leveraged finance we continue to activelyrenegotiate and restructure the transactions to ensure they are executed atoptimal terms.

Fourth, we are examining our risk management organization toenhance particular areas such as convergence risk management and the managementof aggregate exposures by asset class.

Fifth, we have changed pricing and terms on many productsacross the consumer and corporate businesses to reflect the renewed interest inbank funding as a source of capital.

Sixth, in spite of the market dislocation in the thirdquarter which affected our efforts, we are working on pursuing a disciplinedapproach to growing our balance sheet and deploying capital to the highestgrowth and return opportunities.

Finally, as we invest in businesses where we havecompetitive gaps, such as commodities and prime brokerage, we continue todiversify away from our dependence on the fixed income business in Markets& Banking.

While we are diligently working on many issues across thefirm, the underlying business momentum remains very strong across thefranchise. The issues we are dealing with are specific to the marketdislocations in the quarter and we have taken lessons from it to enhance theway we manage the business.

Offsetting the declines I referenced earlier, severalbusinesses showed strong results in the quarter. In fixed income markets,currency and interest rate trading results were strong and revenues were updouble-digits. Equity market revenues were up 19% from a year ago, but down 35%from record second quarter results. Cash, derivatives, and equity financeshowed good growth versus last year, partially offset by weaker results inconvertibles due to lower customer flows.

In our investment banking businesses, we remain number 1 in combined global equity and debtunderwriting for the 24th consecutive quarter. We had record revenue results inadvisory, and advised on eight out of the top ten deals year-to-date. Revenuesin fixed income underwriting were affected by the leveraged loan writedowns;and equity underwriting revenues almost doubled versus last year, but werelower than the record second quarter.

In global transaction services, revenues increased 38% to arecord $2.1 billion, driven by higher customer volumes, stable net interestmargins, and the acquisition of The BISYS Group which closed in August of 2007.Key revenue drivers continued to grow at strong double-digit rates.

Expenses increased 11% versus last year. Lower compensationcosts were offset by significantly higher other operating and administrativeexpenses. These higher operating and administrative expenses are a reflectionof acquisitions, legal costs and other business development costs. Recordrevenues in Asia, Latin Americaand

Mexicoreflected the strength of the franchise in those regions and the fact that themarket dislocations in the U.S.,while affecting some markets, did not have widespread impact across the globe.

The overall investment banking pipeline decreased during thequarter, driven by a drop in leveraged finance activity. However, the M&Apipeline remained at record levels and the equity underwriting pipeline remainsstrong.

Slide 14 shows results in our global wealth managementbusiness. Revenues were up 41% driven by strong customer activity, the impactof Nikko, and the inclusion of theQuilter acquisition. Excluding Nikko,revenues were up 19% and were a record. Assets under fee-based management wereup 38% -- 20% excluding Nikko -- onstrong market actions. Net interest margin increased over the last year inSmith Barney, benefiting from the bank deposit tiering program.

Expenses were up 38%, driven by an increase in compensationcosts on higher revenues and the impact of acquisitions; excluding Nikko,expenses were up 18%. One point to note. Last quarter we completed theintegration of Citigroup Investment Services, which was previously managed andreported in the retail distribution segment into Smith Barney. This resulted ina transfer of 686 FAs and $47 billion in client assets this quarter into SmithBarney. Strong revenue results, good expense control, and the impact ofacquisitions drove an increase in net income of 23%.

Slide 15 shows results in alternative investments and corporateother. In alternative investments, revenue and net income declined, primarilydriven by lower results in our hedge fund activities, the absence of gains fromthe sale of MetLife shares in the third quarter of 2006, and lower market valuein Legg Mason shares. Client revenues were up 75%, reflecting the integrationof Old Lane and organic growth.

Corporate and other income declined, primarily reflectinghigher Nikko-related charges and the absence of a prior-year benefit related toretirement benefits plans, which were partially offset by improved treasuryresults.

Now to wrap up on slide 16, let me give you a few thoughtson the fourth quarter earnings environment. Starting with what we saw inSeptember, there were some promising sign such as better quality leveragedfinance and asset-backed transactions being successfully executed. However,many parts of the fixed income market and many types of investment vehiclessuch as CDOs have shrunk dramatically; and we are not optimistic that they willregain a foothold in the market.

Our underlying business momentum is strong, and we're wellpositioned in many of the fastest-growing countries. We expect our broadpresence and the depth of our client relationships to generate results. Weexpect to continue to rapidly expand our international franchise. As thestructural expense initiatives we announced in early 2007 are on track, they'redelivering the cost savings that we projected. As we embed a discipline ofcontinual re-engineering at the company, we expect to become more and moreefficient, driving stronger bottom line results.

We continue to watch credit very closely. Our expectation,based on the acceleration in our mortgage delinquencies in September that Idiscussed, is that consumer credit in the U.S.will continue to deteriorate in the fourth quarter. Our overall cost of credit,including NCLs and any incremental reserve builds, will reflect the economicenvironment, the credit performance in our portfolio and the portfolio growth.

The situation in Japanconsumer finance remains difficult. Given our experience with the level of greyzone related refunds claims, our best estimates continues to be that thebusiness will have net losses in 2007. We continue to evaluate theprofitability prospects of the business thereafter.

Finally, as you may know, we announced that we wouldcentralize our treasury functions which will facilitate the allocation of capitalto our highest growth and return opportunities.

Let me now open it up for questions and answers.

Question-and-AnswerSession

Operator

Your first question comes from Jason Goldberg - LehmanBrothers.

Jason Goldberg -Lehman Brothers

With respect to earnings, income came in a bit higher thanexpected, despite some writedowns, a bit more than expected. Relative to yourexpectations, what came in better? It seemed like a pretty big difference giventhe quarter was already over.

Gary Crittenden

I wouldn't think about it that way. As you might guess, whenwe were making our estimates at the end of the quarter we hadn’t closed ourbooks, hadn’t been through the closing process at the time. Obviously, we weretrying to be judicious in what we expected the total potential decline inincome to be. It was simply, I think, a judicious call at the time to say thatwe were going to be down by 60%. So I wouldn't think about it any differentlythan that, Jason.

Jason Goldberg -Lehman Brothers

Secondly, can you just talk about off-balance sheetexposure, particularly related to SIVs in terms of what your exposure is? Obviously,a lot of news coming out over the weekend on that.

Gary Crittenden

Yes, we have different types of off-balance sheet exposures.Those that we have some kind of contractual commitment to, we disclose in ourQ. You can see those numbers in our Q. We also manage, as you mentioned, a SIVthat we manage in the UK.We don't have any contractual obligation to provide funding for that SIV, nordo we consolidate it.

Jason Goldberg -Lehman Brothers

With respect to actions announced this morning, can you giveus any color?

Gary Crittenden

I'm not aware that any actions have been officiallyannounced yet.

Jason Goldberg -Lehman Brothers

Lastly, can you talk about leveraged lending exposures? Yougave us the CDO numbers, but the balances in terms of leveraged loans and wherewe stand on that?

Gary Crittenden

As we concluded the third quarter, our net exposures were $57billion.

Operator

Your next question comes from Betsy Graseck - MorganStanley.

Betsy Graseck -Morgan Stanley

A question on the reserve methodology; I know you detailedhow you changed it, the impact of the change, but maybe you could help us understandhow you have worked with the regulators to get them to approve this change? Iam wondering if you even needed regulator approval, because I was under theimpression that it was difficult to change methodologies.

Gary Crittenden

We didn't need any type of regulatory approval here. Therewas actually no methodology change. What we did during the quarter was refineour estimate process. We actually started this back in the second quarter, andwe have been working across our entire consumer portfolio to try and identifybehavioral changes, which at the end of the day, will result in a loss that isembedded in our portfolio today. I gave you an example of that.

Another example might be if you had a mortgage customer, forexample, that is now paying their mortgage three or four days later in themonth that they had historically. We went back and did the correlations on thatkind of thing. We saw that those eventually resulted in losses that wereactually embedded in the portfolio today, but hadn't manifested themselves. Sowe refined our estimate on that, and that accounted, as I said, for a hunk ofthe addition to the loan loss reserve that we did during the course of thisquarter.

But the regulators aren't really involved in that. Thatdoesn't require any kind of regulatory approval. That is just something that wedo as the normal effort to improve the quality of estimating what our eventualloss might be.

Betsy Graseck -Morgan Stanley

Because you indicated that this was the close of the global consumerbusiness review with regard to the reserving levels. Is that right?

Gary Crittenden

This particular setof activities, we have really gone around the world. We did $240 million ofthis, roughly, in the first quarter in the U.S.card business, we did the remainder in this quarter. That effort to try andidentify these relationships that will eventually emerge as losses in theportfolio is now complete.

Betsy Graseck -Morgan Stanley

But if you were to find other indicators that would help youin the reserving methodology, you could tweak again?

Gary Crittenden

We could, yes. Weconstantly are working to try and improve the quality of what we do from areserve estimation process. We certainly could do that in the future as well.

Betsy Graseck -Morgan Stanley

It was my read of the chart on page 9, the net charge-off,net credit losses, and the reserve levels. There is still a gap there, right? Ofabout 20 basis points?

Gary Crittenden

Between what?

Betsy Graseck -Morgan Stanley

The net charge-offsand the loan loss reserves in the global consumer book?

Gary Crittenden

Yes, but that is justpurely coincidence. Those numbers, as you can see historically, have been aboveand below each other. We don't make any particular effort to try and have thosenumbers align.

Betsy Graseck -Morgan Stanley

I am just wondering, in an environment where the consumer isdeteriorating, should we expect that this gap should persist? Or in the past,because it is not showing here on the chart, in deteriorating creditenvironments, whether or not the reserve ratio had been running above netcharge-offs ever?

Gary Crittenden

What I said about my expectations for the fourth quarter isvery much what we feel. We are in a deteriorating credit environment. That wasparticularly pronounced if you look at the bottom of that same page that youare talking about, there really is a deterioration happening in mortgages rightnow.

We think we are running better than the industry based onthe numbers that we can see, but we have a 30-day lag in getting informationfrom the industry. We think we are running better than the industry; but havingsaid that, there clearly was an uptick in the quarter and our expectation isthat that is going to continue as we go into the fourth quarter.

Betsy Graseck -Morgan Stanley

Then on capitalallocation, you have indicated a couple of times that there are lots ofopportunities for improving the efficiency of the capital deployment. Could youjust give us a sense as to what you see some of the low-hanging fruit is, andthe degree to which you could move the needle on ROA or ROE?

Gary Crittenden

During the course of this quarter, and we have been talkingabout it for a time, we organized a central treasury group and appointed a newtreasurer. One of the objectives of that team is obviously to help us toallocate capital in the most efficient way across the company as we possiblycan. We have been through a process of putting together a matrix, more or less,that shows the product categories in which we compete that have low return onregulatory capital and low return on risk capital. Those are the first assetsthat we are focused on.

So if you look on the balance sheet in the supplement, forexample, I'm just going to turn there very quickly. This is now on page 7 ofthe supplement, and you focus on the investment line item of the supplement,you will see that that line item is down by 12%, reflecting, for example, thesale of a significant portion of the mortgage-backed securities that we had inour consumer lending business in the United States. It is examples like that, Betsy,that we are very focused on to try and take out of the portfolio as soon as itmakes economic sense to do so. That is the kind of example that I think servesus well.

Now we have a long-term target for return on equity ofsomewhere between 18% and 20%. We obvious well under-perform that target today,so we have got a lot of work to do to keep the commitments that we have made toyou all. It is not helped, obviously, by the fact that we have had some assetscome on the balance sheet this quarter that were not part of our original plan.But we are attacking those assets, we are going to be thoughtful about this. Wehave someone who I believe is an excellent leader for the treasury function tolead that effort.

It's going to take us a while to reverse the impact of theseassets that have come onto the balance sheet but we have every expectation ofbeing able to make good progress on this over the next couple of years.

Betsy Graseck -Morgan Stanley

The key capital ratio that you are focused on is TCE torisk-weighted managed assets, is that right?

Gary Crittenden

Yes. I mean, Tier 1and TCE are both important, but we are obviously very focused on both. Ourhope, as I mentioned, is that we will return to a more normal level in theearly part of 2008.

Betsy Graseck -Morgan Stanley

More normal level is6.5% on a TCE?

Gary Crittenden

Yes, 6.5%.

Operator

Your next question comes from Guy Moszkowski - MerrillLynch.

Guy Moszkowski -Merrill Lynch

First a factual question. Leveraged finance writedown grossof the fees, because you presented it net of fees?

Gary Crittenden

We haven't disclosed it. Fees typically run 1.5% to 2%, soI'm going to just have to let you make an estimate, because we decided not todisclose.

Guy Moszkowski -Merrill Lynch

We will work with that. On the structured product, the sub-primeMBS writedown, the stuff that was going to go into the structured product, do youhave a gross number there? Would the hedges that you referred to that wouldhave reduced that include structured finance gains on the structured financeliabilities?

Gary Crittenden

If you take the total gross number there – again, we haven'tdisclosed that -- there was significant hedging. So if you look at the way thekind of final position came out, the $1.6 billion, that was net of our hedges.We didn't disclose the hedge number again. I guess the way I would think aboutit is we cut the exposure that we had, as I mentioned, from $24 billion or so atthe beginning of the year down to $13 billion. Coincident with doing that, wealso increased the amount of hedging that we did to what I would say asignificant level. So there was a fairly significant gain on hedges that werereported in the quarter that offset that.

I believe that during the quarter that also included thefair valuing of the liabilities against that number; the answer to that is yes.

Guy Moszkowski -Merrill Lynch

Can we get some roundnumber around the fair value of the liabilities mark?

Gary Crittenden

I think the fairvalue of the liabilities mark in the quarter was $466 million. Now of course,there were also similar counterparty spread movements on the asset side of thebalance sheet that would have roughly offset that amount.

Guy Moszkowski -Merrill Lynch

Can we talk a little bit, in broad strokes, about thecontinued decline in net interest margin? How much of that was due to mix shiftin your deposit base toward deposits that you're actually paying for and howmuch due to some other things?

Gary Crittenden

The underlying trendthere really was heavily influenced by Nikko.So Nikko came on with a lowerfunding cost but lower yielding assets. So, a couple of those basis points wasinfluenced by Nikko. If you takethat out of the picture and just say more aggregately what is happening, whatis happening is that we actually had higher yielding assets in the quarter. Wehad somewhat lower cost of liabilities in aggregate, but the mix shift betweenassets was adverse. That is, the mix because of the Nikkoacquisition and the mix shift towards the trading assets that we have resultedin some deterioration in NIM in the quarter. But the pronounced impact therewas Nikko and Japanese grey zone. Ifyou took those two out of the picture, it was essentially flat on a sequentialbasis quarter over quarter.

Guy Moszkowski -Merrill Lynch

Thanks, that's very helpful. Let me just ask one morequestion, if I might, about the increase in net credit losses and loan lossreserves on the international side, which to me at least seemed surprising, Ithink even beyond Japan consumer finance. Can you give us a little bit morecolor on what you are seeing in the areas beyond the Japanconsumer finance problems in international consumer that caused you to put upsuch a significant increase in reserves?

Gary Crittenden

It is a fair question. Because if you look, for example, onpage 18 of the supplement and focus on the 90-day past due in the cardbusiness, what you see is that it actually had improved some during the courseof the quarter. I think you see that pretty much across International. Thatsaid, we did the exact same exercise internationally that we had done in the U.S.Which is, we made a diligent effort to go through each one of the portfoliosand make sure that if we could identify behavioral patterns that wouldeventually end up in a loss of some sort, that we reflected that and embeddedthat in our reserve today. Obviously, it is not driven by the underlyingdeterioration in delinquencies for the most part. I think that is really whatis there.

Now having said that, we do have some continueddeterioration in Mexicoas part of an ongoing effort that we are making to grow our business there; asuccessful effort to grow our business there. We have had some deterioration,but it is not large enough to reflect itself in the overall numbers for the company.

Guy Moszkowski -Merrill Lynch

Right. One brightspot actually seemed to be GTS, transaction services. The dynamic seemed to bepretty positive there. Maybe you can give us a little bit more color on whatwas going on in that business?

Gary Crittenden

What is going on, frankly, is a continuation of theexcellent things that they have done. So if you look at the underlying metricsfor the GTS business, on just about every count the underlying metrics lookgood. The growth in deposits, the strength that we have internationally in thatbusiness. As you can see, the expense leverage was good in the quarter. Theaddition of BISYS has gone, at least to-date, very smoothly. So that appears tobe a business that is obviously performing very well.

Guy Moszkowski -Merrill Lynch

So there wasn'tanything in it that you thought was an offset to the problems we were seeingelsewhere, just in terms of flight to quality and things like that?

Gary Crittenden

The one thing that did happen during the course of thequarter, as people did not invest in typical kinds of things, so companies thatmight have done asset-backed CP investing in the quarter tended to hold highercash balances. There was some benefit of that that was reflected in thequarter.

Operator

Your next question comes from Glenn Schorr - UBS.

Glenn Schorr - UBS

Could we just get a comment on the asset-backed commercialpaper market? Just in terms of if it was functioning at full 100% strength six months ago or a year ago, where are we atnow? How much has moved on balance sheet and are durations extending at all? Canyou just give a little bit of flavor for what is going on in that market rightnow?

Gary Crittenden

If you don't hold me to a specific percent, I will give youa flavor.

Glenn Schorr - UBS

Just the flavor is great.

Gary Crittenden

If it was 100% awhile ago, it obviously had declined very, very significantly into the Augusttime period and was essentially not functioning. But it had longer termsassociated with it so it doesn't stop functioning and then suddenly there is noasset-backed commercial paper. It terms out over time. As that was being wounddown, you saw the asset-backed commercial paper, as a percentage of our fundingat least, declining. But not declining at a precipitous rate, because it comesoff gradually.

Now beginning about a month ago, the asset-backed commercialpaper market started to reopen. Now we are seeing, for high-quality issues, thereemergence of an asset-backed commercial paper market. But it is not evenanything like the levels that we saw some time ago. So some of that is beingreplaced, at least in our case by term funding; and that is obviously beingbalanced as we go forward.

But there has been a return over the course of the lastmonth to funding. Of course, we have a lot of high-quality assets, particularlyour credit card receivables, things like that, that function very well in thatmarket and we anticipate will be funded just fine as people have become morediscriminating in terms of the assets they are willing to buy.

Glenn Schorr - UBS

What happens to theassets that they are not willing to buy? I agree with you, there is plenty ofstuff that got lumped into the four-letter word. But there are plenty of assetsthat people won't want to buy. So some gets out, and what happens to the stuff-- will it sit on balance sheet, most likely?

Gary Crittenden

I think if you are asking about in the world, I think thatis generally true. If you look at the composition of our assets, thecomposition of our assets are actually very strong. I don't think we are in a position where thatis a significant issue for us individually. But I think generally, that isprobably going to be right.

Glenn Schorr - UBS

I will push the envelope a little on this one. Conceptuallya single master liquidity enhancement conduit, just what is the concept of whyit would exist? Just to provide confidence? Because it doesn't seem like thereis incremental capital being put out. Or would there be capital put out?

Gary Crittenden

Well again, there hasbeen no specific announcement about anything like this, so I don't know if Ishould make any comment about it. But let me just say that it wouldn't besurprising to people on the phone that it would be helpful to have otherliquidity alternatives for SIVs that are managed in the UK.As I understand from what I read in the paper this morning, that is generallythe concept here. Alternatives that would provide liquidity there I think couldprovide reassurance to the market and make the funding there of veryhigh-quality assets a little bit easier.

Glenn Schorr - UBS

Shifting gears to transaction services, are there anynumbers you can throw out on what BISYS would have added on either side of theequation? Like revenue and expense, or just to the bottom line? Because I thinkall the trends still look good. I just want to be able to piece that out.

Gary Crittenden

Glenn, we haven't disclosed it. It is not in the supplementanywhere; and so, no.

Operator

Your next question comes from John McDonald - Banc ofAmerica Securities.

John McDonald - Bancof America Securities

A question on the non-performing assets. There was a bigjump in the commercial side on the back page, total corporate cash basis. Canyou give some color on that?

Gary Crittenden

That is primarily driven by one single name. There are actuallytwo there in total; but one is the larger of the two. IKB AG, a standbycommercial paper arrangement that we had. So they were the funder of a CP. Theywere a funder of a SIV in the UK.We had a standby arrangement to support that SIV. When they became unable toprovide that funding, we had a requirement to step in and provide that funding.You see that as an increase in the cash loans that are there on the balancesheet.

Now, you also see that we took a corresponding increase inour credit reserves in the corporate side of the loan loss reserve. We did thatspecifically in response to this. But that is the largest of the two piecesthat are in that increase that you identify.

John McDonald - Bancof America Securities

So most of the increase from 600 to 1,200 is two things, andyou gave us one of them?

Gary Crittenden

And that is by far and away the largest of the two pieces.

John McDonald - Bancof America Securities

The charge-offs for international card jumped a lot. Is thatMexico?

Gary Crittenden

Mexicowas probably the single largest increase in the quarter. We have had someincrease in Braziland some increase in Indiaas well, but nothing that would have driven the numbers other than those threeitems.

John McDonald - Bancof America Securities

The international carddelinquency is pretty stable, then? What was your outlook there just in the internationalcard?

Gary Crittenden

If you look at it, it is very stable, and we feel prettygood about each of the markets that we have internationally. That said, we didgo through a pretty thorough process to ensure that if we could identify lossesthat were embedded in the portfolio and refine our estimates based on theidentification of those embedded losses that we took them in this quarter. Butit's hard to find that in the delinquency numbers. It is really much more basedon the refinement of the modeling that we have done.

John McDonald - Bancof America Securities

A question on the net interest margin. You look like you aremore wholesale funding reliant than the other U.S.banks. There is some thought that this would make you more a beneficiary of theFed cuts. Theoretically you should have some benefit as the short rates comesdown in your net interest margin, everything else equal?

Gary Crittenden

It depends entirelyon the shape of the yield curve. So the Fed funds rate has come down, but theyield curve shape has really not helped us materially at this point. Thegeneral point that you make is absolutely correct, John. That if the curveshifted in the right way, because of our wholesale fund exposure, it should bebeneficial for us. But it would require the curve to have some steepnessassociated with it and for the low end to shift down.

John McDonald - Bancof America Securities

Which part of thecurve would be most relevant when you talk about that shape, Gary?

Gary Crittenden

If it goes down atthe short end, that is the most advantageous thing to happen for us.

John McDonald - Bancof America Securities

Which it has. I mean,it has gone down on the short end. Something is happening on the long end thatis not helping?

Gary Crittenden

You have got to haveboth the short come down and the long end stay up.

John McDonald - Bancof America Securities

Like the ten-year?

Gary Crittenden

Right, like the ten-year.

John McDonald - Bancof America Securities

Just on expenses, you were supposed to get roughly $2.1billion in expenses this year under the plan previously outlined. Did you saywhere you are on that $2.1 billion expected for '07, how much have you'vegotten so far?

Gary Crittenden

We are going to hitthat number. We haven't disclosed the number that we have hit so far, but weare right on track. In fact, we are probably running just slightly ahead of theplan at the end of the third quarter and we will hit the $2.1 billion that wecommitted.

John McDonald - Bancof America Securities

With the restructuring and management changes, any expectedseverance or anything like that or any restructuring charges from the newbusiness line announced?

Gary Crittenden

No, nothing that iscoming out of the activities that we just announced last week. Now, one of thethings I should point out is that we have ongoing re-engineering activities andfrom time to time from in those ongoing re-engineering activities there will beseverance costs, restructuring charges that we will take. Those may or may nothappen in quarters when we have gains that happen at the same time. But thereis certainly nothing coming out of what we have just done that would generate arestructuring charge.

Operator

Your next question comes from Ron Mandle - GIC.

Ron Mandle - GIC

I was just wondering how much foreign exchange might haveadded to revenue growth in the quarter?

Gary Crittenden

FX added 2% to revenue growth in the quarter.

Ron Mandle - GIC

Second on the loan loss reserve, you mentioned that you sawcredit deterioration in September. I am wondering why you didn't build thereserve more than you did, given that you basically said you were going tobuild it more in the fourth quarter?

Gary Crittenden

Well, first of all wedid. So if you look at what we announced the reserve to be for credit costs atthe time we did the October 1 announcement, it was a couple hundred milliondollars lower than what we actually ended up doing. That came because as wefinished the quarter, we obviously saw this uptick that took place during thelast two weeks of September.

The credit losses that you recognize have to be creditlosses that are embedded in the portfolio as it exists today. So you can doyour best to forecast behavioral changes like we have, you can look atmacroeconomic factors and talk about how those macroeconomic factors influencewhat you believe the embedded losses to be in the portfolio today. All of thosethings you can do. What you can't do is look forward and anticipate losses thatare not yet in your portfolio. But you might have a view which you can embed inthese macroeconomic judgments that you make that your current portfolio isgoing to recognize those losses. But you can't pull future losses obviouslyinto this quarter.

Ron Mandle - GIC

So in other wordsthen, you built the reserve in anticipation of higher fourth quarter losses, soyou will not have to build the reserve in the fourth quarter.

Gary Crittenden

Let me just tell you the way I would think about it. The wayI would say it is that there are a series of macro economic factors. Let mejust give you an example. If you look at the number of days homes are sittingon the market, if homes are sitting on the market for a longer period of timethat probably means that we have embedded in our portfolio today losses thathave not yet emerged but will eventually have to be recognized. We have triedto take into account those types of macro economic factors in assessing thereserve.

However, beyond that kind of thing, you can't anticipate aloss that is not embedded in your portfolio today. If there is significant deteriorationin the credit environment that goes beyond where things are today, we simplycan't embed that because we have that expectation.

Ron Mandle - GIC

In terms ofasset-backed commercial paper and other disruptions in the quarter, I waswondering how much your balance sheet might have gone up in the quarter becausethose disruptions of that sort?

Gary Crittenden

Well, we didn't splitit out specifically during the quarter. You can get a little bit of a flavorfor it, obviously, by going through the piece parts of what happened. But wehaven't specifically identified the balance sheet increase associated withdislocations.

Ron Mandle - GIC

Would you give ussome guidance in that regard?

Gary Crittenden

I don't think so.

Ron Mandle - GIC

Finally, I'm just wondering, you have made the managementchanges. I am wondering what criteria the board uses to decide how high up themanagement changes should be, given a quarter like this.

Charles Prince

I think the board's criteria for that is to see whether ornot we have a good, sustainable strategic plan, one that can see us through along-term set of performance, especially with the kind of headwinds that comelike this quarter's aberrational impact of the fixed income. I think with thatkind of criteria, the board feels comfortable at the levels that we have madethe changes.

Ron Mandle - GIC

So that kind of assumes that markets and business trendswill normalize in the fourth quarter and beyond, and that you will be back onthe track that you thought you were on at the end of the second quarter?

Gary Crittenden

I think the best way to think about that, Ron, is to gothrough the comments that I made on slide 16. I stepped through each one of themajor business lines and talked about the factors that we think are the currentupdate of where our performance is in the fourth quarter.

Operator

Your next question comes from Mike Mayo - Deutsche Bank.

Mike Mayo - DeutscheBank

Chuck said this was the year of no excuses. You guys say theresults are disappointing. So what are the repercussions at the level of the Officeof the Chairman? When I look at results, and feel free to educate me, but thebusiness line mishaps are not just investment banking. There are some otherareas. There are some risk management issues. Expense management, no matter howyou look at it, year-over-year, year-to-date, linked-quarter, you add back thecharges, reducing some for comp, you still have negative operating leverage.

Then management. It was a year ago when Tom Maheras, MichaelKlein were moved to head the Investment Bank and now that has kind of changed alittle bit. Also, Dave Bushnell, Head of Risk Management, was promoted threeweeks before the preannouncement. I was not sure what was going on with that.

But the bottom line here is almost all the investors that Italk with feel like there needs to be more significant changes in terms ofmanagement. So that is the data I am looking at. What are you looking at, orwhat is the board looking at that they feel more comfortable?

Charles Prince

I think I would repeat a large part of what I said to Ron.It sounds to me like a very similar question. If you look at our results thisquarter, no one can be happy with the results in our fixed income business orwith the results that relate to that. But I think if you are able to look atthe other parts of our business, if you look at the strategic plan that we areexecuting on, I think any fair-minded person would say that strategic plan isworking. The benefits that we saw in the fourth quarter and then more in thefirst quarter and then more in the second quarter are showing through in thethird quarter in the businesses that haven't been impacted severely by thefixed income dislocations.

So if you look at parts of securities and banking, and wecalled those out; if you look at our international business; if you look at ourGTS business; if you look at our wealth management business; if you look at ourvarious businesses, the trend line of growth that we have sustained now forseveral orders is continuing. It is clear that the fixed income dislocationhurt us, and hurt us in a very significant way in those businesses. But I thinkI certainly have confidence in our strategic plan. I think that it is showingthrough. I personally expect that itwill continue to show through in the future. I think those are the factors thatpeople are looking at.

Mike Mayo - DeutscheBank

Well, one of your main targets for this year was to growrevenues faster than expenses and that is not going to pan out. This could bethe third year in a row where that doesn't pan out. That was clearly a veryimportant factor. Also at the corporate level, the risk management you said itwas on the extreme areas of where you thought it should be. How do you thinkabout that?

Charles Prince

Well, you ask two questions there. Obviously, we wantrevenues to grow faster than expenses. It is true in many of our businesses. AsI said, we had a very severe dislocation in revenues in our Markets &Banking business, one that I am not sure any fair-minded person would see a wayto lower expenses rapidly enough to offset that in a five-week period. In therest of our business, I think we are actually making very considerable progressin that.

In terms of risk management, obviously, we wish that ourrisk management models had predicted what had happened here. In fairness, theyincluded it, but only at the wide margins of what we thought was possible. I amnot sure we were alone in that difficulty. But the facts are the facts. Our jobis to sustain our strategic plan is we go forward, and that is what we're goingto do.

Mike Mayo - DeutscheBank

As it relates to risk management, the promotion, or maybeit's not a promotion. I am not sure what it was. The addition toresponsibilities of the risk management head three weeks before thepreannouncement?

Charles Prince

I am not sure of yourquestion, Mike, but it was a promotion for David. David has taken on a broaderset of responsibilities. Again, I don't see risk management as a guarantor ofresults in the kind of market dislocations that we have had this quarter, so Idon't see that as a connection at all.

Mike Mayo - DeutscheBank

I mean, reasonable people can disagree. If you don't likethe Office of the Chairman or the way it is being run, you just sell yourstock. But my question is, I saw Robert Rubin quoted in the press saying thatyour job should be safe for four years from now. Did the board kind of reaffirmyour CEO status for the next several years? To what degree was your job titlereinforced?

Charles Prince

I don't think itwould be appropriate for me to comment on what Bob said or about what the boardmight be thinking in that regard.

Mike Mayo - DeutscheBank

But you did say the boardfeels comfortable with the levels of changes that have been made. So should weassume that the changes are done?

Charles Prince

Again, Mike, I think it just wouldn't be appropriate for meto comment further on that subject.

Operator

Your next question comes from Meredith Whitney - CIBC WorldMarkets.

Meredith Whitney -CIBC World Markets

I have some operational questions regarding cards, mainlyinternationally, but also domestically, and then Japan'sgrey zones.

With respect to cards domestically, you haven't seenreceivable growth in some time on a year-on-year basis. You have seen prettyrapid growth specific to Latin America in international.What is your strategic effort, strategic aspiration to grow the domestic cards,the U.S.business? What tenets do you have in place to grow that business? What are youraspirations again? What governors do you have in place to manage credit losseson the Latin American or international side given the fact that the growth isso outsized?

My last question related to the grey zones is, you havegiven guidance to 2007. But can you extend that out to 2008 in terms of what you expect interms of the earnings impact from the grey zone change in law to be? Thanks.

Gary Crittenden

That was a long list. I hope I get them all, Meredith. Onthe first one, we have a pretty concerted effort around re-engineering in ourU.S. cards business that I think is going to generate investment dollars for usnext year that will be larger than what we have had in that business over thelast few years.

Essential for that business is having the right level ofmarketing support. This will provide additional marketing support for thatbusiness going forward that hopefully will allow it to do reasonably well. Thatis a relatively mature market in the U.S.from a receivables perspective and the result of that is compared to theinvestment options that we have outside the United States, we really do look to them to fundtheir growth.

Now having said all that I have just said, the group hasdone a really good job of bringing down promotional balances in that business.That has had a negative impact on our overall receivables growth, but it hashad a positive impact on the margin in the business. So you have to look atthose going in both directions.

We are obviously very focused on the credit performanceoutside the U.S.I think that is underlined by the fact that we took a $1 billion increase inloan loss reserve to make sure that we have gone through each of thoseportfolios and identified what within the portfolio might indicate thepossibility of a loss that is embedded in the portfolio today, but is not yetevident to us. That has been a very comprehensive process. It went on for thelast couple of quarters and concluded, as I said, with the results that areembedded in our results this quarter.

But having said that, we are still very much on top oflooking at each of these individual countries that are growing very rapidly,and trying to govern the growth rates appropriately to ensure that the loanlosses that we have foreseen there are appropriate for what the growth andeventual maturation of the portfolio will be.

Meredith Whitney -CIBC World Markets

Can I just follow upreal quick before you do Japan? Most of the growth in the domestic portfoliohas been through acquisitions of private label portfolios. What does the coreportfolio look like, exclusive of the private label growth? What does growthspecifically look like there? Can you give some tangible examples about howyou're marketing to grow that portfolio?

Gary Crittenden

The additional portfolios that have been acquired arerelatively immaterial; that is, for right now. So you have got the Federatedportfolio that has come in during the course of the last year. So the largerportfolios that you have in mind are really a little bit further back. So thereis a modest impact from Home Depot, modest impact from Federated, but reallyrelatively small.

You know, the most recent example of something that theyhave done is a relaunch of the AT&T universal card. That happened about amonth ago. There is a brand new value proposition that has been launched withAT&T with a whole set of new reward options associated with it, and I thinkis a good example of an effort to revitalize a product that is a significantpart of our portfolio, but has not grown very much over the last little while.

I think there is a three-sided effort here. One is to takethose parts of our portfolio that have not been growing well and go throughsome effort to revitalize them; AT&T is like that. There is a focus on thefaster-growing segments of the portfolio, like travel and entertainment andsmall business. That is a second effort that that team is working on. Then thethird, as you quite correctly point out, are partnership efforts that areunderway. All of those, hopefully, are underpinned by a more effectivere-engineering strategy next year that will provide them some capacity toexpand their marketing efforts.

From a grey zone perspective, I would be the last person,frankly, to make a forecast for 2008 financial results. That is a fluidsituation, I think is the best way to describe it. It is important to take awaythat we did writedown to zero the remaining specific intangibles that wereassociated with this business in this quarter. So, there won't be any chargesassociated with that in future quarters.

As you know in the fourth quarter of last year, we took acharge of north of $600 million to reflect what we think the refund claims willbe. But it is obviously difficult to say, given the environment around thatbusiness, exactly how it will evolve in 2008.

Meredith Whitney -CIBC World Markets

Just to clarify, when you talk about the grey zone lossextending throughout the fourth quarter of 2007, is that new information? Or isthat just a reiteration of what you had said all along?

Gary Crittenden

I think at the end of the second quarter, I said that weexpected a loss on a full-year basis.

Meredith Whitney -CIBC World Markets

Right, but I thoughtyou had said that at the end of the year, or Chuck had said at the end of lastyear as well.

Gary Crittenden

No, we had expectedthat we would breakeven this year at the end of last year. But we have now saidfor a couple of quarters that we expect it to lose money.

Operator

Your next question comes from Jeff Harte - Sandler.

Jeff Harte - Sandler

Good morning. Most of my questions have been hit on. But acouple, and this is going to be a tough one to answer, but somewhatforward-looking in the investment bank. We are sitting here after a difficultquarter for mortgages and CDOs; and I believe you made a comment earlier aboutsome of those structured finance products really not getting a foothold again. Aswe look back over the last couple of years, how important were those businessesfor driving revenues in the investment bank? As you start looking to 2008, whatkind of budgeting thoughts do you have for what kind of strength we could seein the wake of the troubles this summer?

Gary Crittenden

Well, they have beenimportant for us and obviously have represented a hunk of the growth that wehave had in the investment bank over the course of the last couple of years, butthey aren't the only area where we have had significant activities underway totry and grow our investment banking business. Those elements of our plan areclearly in place.

So if you look at the success, for example, that we have hadwith equity derivatives from 2006 into 2007 that change there has been actuallypretty good. The growth in interest rate structuring, 2006 to 2007, looks verygood. So, I think in these areas where we are making strategic investments,which also include commodities and FX options, we are going to continue toreinforce and invest behind these categories as particularly they overlap withemerging markets where we have strong, fundamental positions.

So, this is a business which you know changes very rapidlyover the course of years. If you look at any business configuration among anyof our competitors and go back five years and compare it to today, this is abusiness that evolves and follows the market opportunity. We intend to doexactly the same thing.

Charles Prince

Jeff, I might addthat one of the things that we are taking into consideration is that over thelast four or five years providers of liquidity have not generally been rewardedfor that. I think at least in the intermediate period in front of us, providersof liquidity will have a greater reward for that effort than they have had in thepast.

Jeff Harte - Sandler

Finally on the trading side, a difficult quarter, but it wasa difficult quarter for most. You talked a little bit about working on systemsto improve the aggregation of risk exposure over positions, geography. Can youtalk a little bit about that? Because you guys really span the globe more thanmost, and products more than most. How able are you to aggregate things likecredit risk and even interest rate risk across the franchise?

Gary Crittenden

It is actually more a question of how we think about things,I think. Let me just give you a quick example. We have had a process over thelast couple of years that has kept our growth in sub-prime mortgages on theconsumer side in check, basically. That has not expanded very much. If you lookat our mortgage trading results in the second quarter, although we didn't splitthat out as a separate category, they were actually okay during the course ofthe quarter.

In part that was because the credit risk team was veryfocused on the exposures in both of those categories. The CDOs in large measurewere managed by our market risk teams and they were very concerned about thechange in interest rates as it would affect the valuation on the CDO warehouse.The cross-pollenization between the credit risk team and the market risk teamwas not as strong as it needed to be.

One of the things that we have learned from this wholeexperience is that we have to have more integration between the way those teamsoperate so that risks that are apparent and coming up in one area, thathistorically have not been relevant for another area, are available to us so wecan see them and make sure that we anticipate them in the future. That isspecifically the kind of thing that I was referring to in my comments.

With regards to interest rate risk, we obviously know whatour position is at any moment in time. What we have talked about on these callsin the past is we need a better capability to forecast under various scenarioson a companywide basis how that interest rate is going to change. We still needto make progress in that regard. It is going to take us into next year beforewe actually have good dynamic capability under multiple scenarios to forecastout what our net interest margin is going to be. That is one of the initiativesthat our central treasury group is working on.

Operator

Your next question comes from Vivek Juneja – JP Morgan.

Vivek Juneja – JPMorgan

Can you comment on the U.S.consumer as well as the international consumer business? If you look at them exthe reserve build, there has really been no net income growth. When should weexpect that? What is it that will help drive that, given that you are startingto see a pickup in losses now? Just stepping aside from the reserve build.

Secondly, if you can comment a little bit on the alternativeinvestments business, given that you have added of a lot of international stuffwith Old Lane, it was stilla difficult quarter. How should we expect results in that business to start toshow up?

Gary Crittenden

If I think about the U.S.consumer business, I think this was a little bit of an unusual quarter. So U.S.consumer has done a nice job rebounding off of the lows of a couple of yearsago, in terms of their revenue performance. You all have seen the chart that wehave used in many different circumstances that showed the turnaround in revenueperformance in that business being roughly in the 4% to 6% range over the lastfew quarters.

This quarter, there were actually market-related events thathad to do with a couple of specific items, securitization and the way we markedthe I/O strip to market, that resulted in a negative impact on the results inthis quarter. Also, we had a gain on the sale of some securities in the thirdquarter of last year that made this quarter's momentum look weaker.

The fundamental trend, the fundamental revenue growth rateis basically the same in that business this quarter as it was last quarter.Last quarter we were impacted by a pretty significant reserve build,particularly when compared to the prior year. So we had reserve releases in theprior year. We took, again, some of the refinement to estimate addition to ourreserve in the second quarter.

I think the elements are largely in place. That business hashad operating leverage on a year-to-date basis with the exception of what hasjust happened in this quarter and we have had now significant charges from acredit perspective. We are certainly hoping that on a normalized basis thisbusiness will perform as one would expect it to perform.

Internationally, we have made very significant investmentsin operating expenses. We have grown the branches there very significantly. Youcan see the number of branches that we have grown. The revenue growth ratethere is strong. If you again take out the Japanese grey zone and you look atthe business without Japanese grey zone, the underlying performance of thatbusiness is actually very attractive and it is obviously a key area forinvestment for us in the future, and anticipate that to be a business that willreturn very attractive results for us.

In alternatives, that is a very difficult business quarter toquarter to manage the underlying results. If you look at the results the firsttwo quarters of this year, they did better than what we had anticipated, betterthan the guidance that we had provided. That was also true of the fourthquarter of last year. They did less well this quarter than what we hadanticipated and less well than what our typical average guidance might be forthat business as well. But I think it's very difficult to say quarter to quarterthat that business is going to have a consistent financial result.

Vivek Juneja – JPMorgan

Going back to the U.S.consumer, given that yes the operating leverage, if you look at just youraverage expenses are improving, but you have to factor in the credit costs. Itis not just the reserve build. Your credit losses are starting to climb. If youfactor that in, you are not growing your bottom line; and ultimately that iswhat matters. What are your plans to try to improve that? Because obviouslywith the interest rate environment moving away from being as negative as it waspreviously, it is easier to make the operating leverage look better. Butnet-net is what matters.

Gary Crittenden

Well, I certainlyagree with you that net-net is what matters. We have done what we believed wasnecessary to do from a reserving standpoint to capture the losses that areembedded in the portfolio today. I gave you my sense of what I anticipatedcredit to do as we move into the fourth quarter. I believe we have good metricperformance in that business. If you look at deposit growth and loan growth onthe chart on the page, we have got good operating expense constraints that havebeen operating in that business as we have gone through this year. Obviously,we are at a point in the credit cycle that has been difficult for us. There isno doubt about it. That may very well impact us as we go into the fourthquarter.

Vivek Juneja – JPMorgan

Is it partly alsobecause you have just stretched, just like you did in the fixed incomebusiness, certain areas that are coming back that have grown a little toorapidly, so you are pulling back in areas such as home equity?

Gary Crittenden

I am not sure that Iunderstand exactly the point that you are making.

Vivek Juneja – JPMorgan

The point being thatcertain areas such as home equity have grown really fast, are you cutting backon that in any way?

Gary Crittenden

As I said in thecomments that I made in the script, we have cut back on third-partyoriginations in the home equity business and are primarily using our ownsources of origination. But if you look at the parameters of our portfolio, weneither grew as rapidly in the sub-prime portions of that business as othersdid, and we have very attractive FICO scores in that business. If you look atthe growth in delinquencies in the first and second mortgage portfolio,although they are large, as I mentioned in my talking points, at least as wehave industry numbers here, we are performing substantially better than theindustry. We don't have the industry numbers for September, but up throughAugust we were doing better than the industry.

Vivek Juneja – JPMorgan

Lastly just a littledetail. Tax rate, how should we think about it going forward since ands you hadanother quarter where it was a nice benefit? What is a way to think about thatfrom a normalized standpoint?

Gary Crittenden

Obviously, I wouldn't assume that this quarter's tax rate isa typical kind of a number. There were a number of advantages in this quarterthat we had. You can go back historically and see what this has averaged. Iwould go back and use historical numbers rather than provide you some kind of aforecast.

Operator

Your final question comes from Diane Merdian - KBW.

Diane Merdian - KBW

I was also going to ask on the tax rate. I guess the onlything I would add, based on your comment, is should we make some adjustment tothe normalized tax rate that we have observed over time, based on the mixbetween international and U.S., which is shifting over time? Separately, I washoping to maybe get some insights on the size of the I/O writedown andsecuritization gains. Finally, I was curious if you would give us any senseabout the portion of expenses in securities and banking that is non-comp.

Gary Crittenden

Portion of expensesthat is non-comp? In terms of the tax rate, obviously the growth rate ininternational has been helpful for us. If you go through the actual rates forthe first part of this year, it was about 27% in the first quarter; 29.9% inthe second quarter; 27.4% in the quarter we have just come through. Those areall related, for the most part, to discrete planning activities that we haveengaged in that are beneficial for us from an international perspective. Themore we grow our business internationally, the more those kinds ofopportunities are available for us.

Again, I wouldn't want to forecast out at these relativelylow levels of tax rates. I would look towards the last couple years and do someaveraging based on the last couple of years rather than forecast off of theselevels, Diane.

In terms of the I/O writedown, the I/O writedown was about$107 million in the quarter. The securitization gains in this quarter were lessthan they were last year. They were less than last year by over $100 million.

Then, the portion of our expenses that is non-operating I'mnot going to give you specifically; but if you look in the Markets &Banking supplement, I think the total amount of non-comp expenses is $2.2billion. How that relates to comp, you can obviously see back on page 23 of oursupplement.

Thanks, everyone for joining with us today.

Art Tildesley

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