WELLS FARGO & CO/MN
Form 10-Q
May 07, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2007
Commission file number 001-2979
WELLS FARGO & COMPANY
(Exact name of registrant as specified in its charter)

Delaware	41-0449260
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

420 Montgomery Street, San Francisco, California 94163
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: 1-866-249-3302

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

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

Large accelerated filer þ 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 þ

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

	Shares Outstanding April 30, 2007
Common stock, $1-2/3 par value	3,339,747,324

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PART I FINANCIAL INFORMATION
FINANCIAL REVIEW
SUMMARY FINANCIAL DATA

		Quarter ended		% Change Mar. 31, 2007 from	
($ in millions, except per share amounts)	**Mar. 31, 2007**	Dec. 31, 2006	Mar. 31, 2006	Dec. 31, 2006	Mar. 31, 2006
For the Quarter					
Net income	**$ 2,244**	$ 2,181	$ 2,018	3%	11%
Diluted earnings per common share	**0.66**	0.64	0.60	3	10
Profitability ratios (annualized):					
Net income to average total assets (ROA)	**1.89%**	1.79%	1.72%	6	10
Net income to average stockholders equity (ROE)	**19.65**	18.99	19.89	3	(1)
Efficiency ratio (1)	**58.5**	57.5	59.3	2	(1)
Total revenue	**$ 9,441**	$ 9,413	$ 8,555		10
Dividends declared per common share	**0.28**	0.28	0.26		8
Average common shares outstanding	**3,376.0**	3,379.4	3,358.3		1
Diluted average common shares outstanding	**3,416.1**	3,424.0	3,395.7		1
Average loans	**$ 321,429**	$ 312,166	$ 311,132	3	3
Average assets	**482,105**	482,585	475,195		1
Average core deposits (2)	**290,586**	283,790	257,466	2	13
Average retail core deposits (3)	**223,729**	220,025	213,876	2	5
Net interest margin	**4.95%**	4.93%	4.85%		2
At Quarter End					
Securities available for sale	**$ 45,443**	$ 42,629	$ 51,195	7	(11)
Loans	**325,487**	319,116	306,676	2	6
Allowance for loan losses	**3,772**	3,764	3,845		(2)
Goodwill	**11,275**	11,275	11,050		2
Assets	**485,901**	481,996	492,428	1	(1)
Core deposits (2)	**296,469**	288,068	263,136	3	13
Stockholders equity	**46,135**	45,876	41,961	1	10
Tier 1 capital (4)	**36,476**	36,808	32,758	(1)	11
Total capital (4)	**50,733**	51,427	45,331	(1)	12

Capital ratios:					
Stockholders equity to assets	**9.49%**	9.52%	8.52%		11
Risk-based capital (4)					
Tier 1 capital	**8.70**	8.95	8.30	(3)	5
Total capital	**12.10**	12.50	11.49	(3)	5
Tier 1 leverage (4)	**7.83**	7.89	7.13	(1)	10
Book value per common share	**$ 13.77**	$ 13.58	$ 12.50	1	10
Team members (active, full-time equivalent)	**159,600**	158,000	152,000	1	5
Common Stock Price					
High	**$ 36.64**	$ 36.99	$ 32.76	(1)	12
Low	**33.01**	34.90	30.31	(5)	9
Period end	**34.43**	35.56	31.94	(3)	8

(1) The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income).

(2) Core deposits are noninterest-bearing deposits, interest-bearing checking, savings certificates, market rate and other savings, and certain foreign deposits (Eurodollar sweep balances). During 2006, certain customer accounts (largely Wholesale Banking) were converted to deposit balances in the form of Eurodollar sweep accounts from off-balance sheet money market funds and repurchase agreements. Included in average core deposits were converted balances of $9,888 million,

$8,888 million and $1,234 million for the quarters ended March 31, 2007, December 31, 2006, and March 31, 2006, respectively. Average core deposits increased 10% from first quarter 2006 and 9% (annualized) from fourth quarter 2006, not including these converted balances.

(3) Retail core deposits are total core deposits excluding Wholesale Banking core deposits and retail mortgage escrow deposits.

(4) See Note 19 (Regulatory and Agency Capital Requirements) to Financial Statements for additional information.

This Report on Form 10-Q for the quarter ended March 31, 2007, including the Financial Review and the Financial Statements and related Notes, has forward-looking statements, which may include forecasts of our financial results and condition, expectations for our operations and business, and our assumptions for those forecasts and expectations. Do not unduly rely on forward-looking statements. Actual results might differ significantly from our forecasts and expectations due to several factors. Some of these factors are described in the Financial Review and in the Financial Statements and related Notes. For a discussion of other factors, refer to the Risk Factors section in this Report and to the Risk Factors and Regulation and Supervision sections of our Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Form 10-K), filed with the Securities and Exchange Commission (SEC) and available on the SEC s website at www.sec.gov.

OVERVIEW

Wells Fargo & Company is a $486 billion diversified financial services company providing banking, insurance, investments, mortgage banking and consumer finance through banking stores, the internet and other distribution channels to consumers, businesses and institutions in all 50 states of the U.S. and in other countries. We ranked fifth in assets and fourth in market value of our common stock among U.S. bank holding companies at March 31, 2007. When we refer to the Company, we, our or us in this Report, we mean Wells Fargo & Company and Subsidiaries (consolidated). When we refer to the Parent, we mean Wells Fargo & Company.

In first quarter 2007, we achieved record diluted earnings per share of $0.66, up 10% from a year ago, and record net income of $2.24 billion, up 11% from a year ago. Our first quarter 2007 results reflected the balance across our broadly diverse business segments, continued improvement in operating margins, and a modest decline in net credit losses from fourth quarter 2006 levels. In terms of business performance, growth was once again well balanced between consumer and commercial with most of our 80 plus businesses producing double-digit earnings or revenue growth in the quarter. In terms of operating margins, net interest margin improved to 4.95%, up 10 basis points from a year ago; return on assets, which includes credit costs, improved to 1.89%, up 17 basis points from a year ago; operating leverage was positive with revenue growth of 10% exceeding 9% expense growth; and return on equity remained strong at 19.65%, among the best in the industry. Earnings growth and operating margins were solid and improved in first quarter 2007, despite an increase in nonperforming assets and credit charge-offs from a year ago, reflecting in large part our ongoing discipline in managing our businesses and balance sheet for industry-leading risk-adjusted returns.

Our vision is to satisfy all our customers financial needs, help them succeed financially, be recognized as the premier financial services company in our markets and be one of America s great companies. Our primary strategy to achieve this vision is to increase the number of products our customers buy from us and to give them all of the financial products that fulfill their needs. Our cross-sell strategy and diversified business model facilitate growth in strong and weak economic cycles, as we can grow by expanding the number of products our current customers have with us. Our average retail banking household now has a record 5.3 products with us. Our goal is eight products per customer, which is currently half of our estimate of potential demand. Our core products grew this quarter compared with a year ago, with average loans up 3%, average core deposits up 13% and assets managed and administered up 26%.

We believe it is important to maintain a well-controlled environment as we continue to grow our businesses. We manage our credit risk by setting risk-adjusted credit policies for underwriting, while continuously monitoring and reviewing the performance of our loan portfolio. We maintain a well-diversified loan portfolio, measured by industry, geography and product type. We manage the interest rate and market risks inherent in our asset and liability balances within prudent ranges, while ensuring adequate liquidity and funding. Our stockholder value has increased over time due to customer satisfaction, strong financial results, investment in our businesses, consistent execution of our business model and the management of our business risks.

Our financial results included the following:

Net income for first quarter 2007 increased 11% to $2.24 billion from $2.02 billion for first quarter 2006. Diluted earnings per share for first quarter 2007 increased 10% to $0.66, from $0.60 for first quarter 2006. Return on average assets (ROA) was 1.89% and return on average stockholders equity (ROE) was 19.65% for first quarter 2007.

Net interest income on a taxable-equivalent basis increased 3% to $5.04 billion for first quarter 2007 from $4.89 billion for first quarter 2006 driven by a 1% increase in average earning assets and a 10 basis point increase in the net interest margin. The net interest margin was 4.95% for first quarter 2007, compared with 4.85% for first quarter 2006. The completion of the sales of adjustable rate mortgages (ARMs) and lower-yielding investment securities last year reduced the earning asset growth rate year over year, but helped increase the net interest margin. Net interest margin continued to benefit from growth in core deposits.

Noninterest income increased 20% to $4.43 billion for first quarter 2007, from $3.69 billion for first quarter 2006. Growth in fee income was strong, reflecting our ongoing success in cross-selling products and services to both consumer and commercial relationships. Deposit service fees rose 10% reflecting solid growth in deposit balances and accounts; trust and investment fees rose 10% reflecting increases in equity/bond markets from a year ago and success in building new wealth management relationships; debit and credit card fees rose 22% reflecting deeper customer penetration rates and increased activity; insurance fees rose 10% reflecting higher revenue; and mortgage banking fee income was higher due to increased originations and a 41% increase in gross servicing income, including the $140 billion servicing portfolio acquired last year. In line with our asset/liability management process, we sold $4 billion of our lowest-yielding bonds in first quarter 2007 at a gain of $29 million.

Revenue, the sum of net interest income and noninterest income, grew $886 million, or 10%, to $9.44 billion in first quarter 2007 from $8.56 billion in first quarter 2006. Community Banking and Wholesale Banking revenue growth was 12% and 15%, respectively, reflecting the strength and balance of our business model. Businesses with double-digit, or near double-digit, year-over-year revenue growth included commercial banking, asset-based lending, asset management, international/trade finance, capital markets, real estate brokerage, business direct, wealth management, card services, home equity lending, personal credit management, corporate trust, and home mortgage. Year-over-year revenue growth was driven by growth in net interest income and particularly strong increases in fee income across products and services, reflecting continued growth in cross-sell. Given the deterioration in the nonprime mortgage market during first quarter 2007, we took a number of actions that reduced revenue by approximately $90 million

(pre tax), including reducing the carrying value of all nonprime loans in our mortgage warehouse and providing for additional estimated early payment default losses on securitized mortgages. In addition, given the decline in mortgage rates during the quarter, revenue was reduced by $34 million (pre tax) reflecting the decline in the value of mortgage servicing rights (MSRs) net of hedging.

Noninterest expense was $5.53 billion for first quarter 2007, up $452 million, or 9%, from first quarter 2006. The increase was primarily driven by continued investment in our businesses, both additional sales personnel and new stores. During first quarter 2007, we opened 18 regional banking stores, added 57 new *webATM*® machines and converted 151 ATMs in Central California to *Envelope-Free*SM *webATM* machines to better serve our customers. Expenses in first quarter 2007 included $50 million of stock option expense, $29 million of seasonal FICA expenses and $16 million of integration costs.

Net charge-offs for first quarter 2007 were $715 million (0.90% of average loans outstanding, annualized), compared with $726 million (0.92%) during fourth quarter 2006 and $433 million (0.56%) during first quarter 2006, which was positively impacted by historically low personal bankruptcies after the fourth quarter 2005 bankruptcy spike caused by the then impending change in the bankruptcy law. Auto related losses for first quarter 2007, while still at historically elevated levels, declined from third and fourth quarter 2006 due to our intensive management efforts, in both collections and underwriting, along with seasonality. Losses remained at predicted levels in our consumer unsecured and small business portfolios, and we continued to experience historically low losses in our commercial portfolios. Home equity losses have increased due to current real estate market conditions, including stress in certain regional markets, along with underperformance in home equity loans acquired from correspondents. We have tightened our underwriting standards and focused additional collections resources on targeted portfolio segments. During 2007, we expect higher but manageable losses in the home equity portfolio.

The allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, was $3.96 billion, or 1.22% of total loans, at March 31, 2007, compared with $3.96 billion, or 1.24%, at December 31, 2006, and $4.03 billion, or 1.31%, at March 31, 2006.

Total nonaccrual loans were $1.75 billion, or 0.54% of total loans, at March 31, 2007, compared with $1.67 billion, or 0.52%, at December 31, 2006, and $1.39 billion, or 0.45%, at March 31, 2006. Total nonperforming assets (NPAs) were $2.67 billion, or 0.82% of total loans, at March 31, 2007, compared with $2.42 billion, or 0.76%, at December 31, 2006, and $1.85 billion, or 0.60%, at March 31, 2006. Foreclosed assets were $909 million at March 31, 2007, compared with $745 million at December 31, 2006, and $455 million at March 31, 2006. Foreclosed assets, a component of total NPAs, included $381 million, $322 million and $227 million of foreclosed real estate securing Government National Mortgage Association (GNMA) loans at March 31, 2007, December 31, 2006 and March 31, 2006, respectively, consistent with regulatory reporting requirements. The foreclosed real estate securing GNMA loans of $381 million represented 12 basis points of the ratio of nonperforming assets to loans at March 31, 2007. Both principal and interest for GNMA loans secured by the foreclosed real estate are fully collectible because the GNMA loans are insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs. Commercial nonperforming assets continued at historically low levels, and our loan impairment

analysis indicated only modest loss potential. We are constantly monitoring residential mortgage and auto nonperforming levels and have active programs to determine the best strategy to hold and workout or sell these assets.
The Company and each of its subsidiary banks continued to remain well-capitalized. During first quarter 2007 we repurchased $1.6 billion of our common stock. The ratio of stockholders equity to total assets was 9.49% at March 31, 2007, 9.52% at December 31, 2006, and 8.52% at March 31, 2006. Our total risk-based capital (RBC) ratio at March 31, 2007, was 12.10% and our Tier 1 RBC ratio was 8.70%, exceeding the minimum regulatory guidelines of 8% and 4%, respectively, for bank holding companies. Our RBC ratios at March 31, 2006, were 11.49% and 8.30%, respectively. Our Tier 1 leverage ratios were 7.83% and 7.13% at March 31, 2007 and 2006, respectively, exceeding the minimum regulatory guideline of 3% for bank holding companies.

Current Accounting Developments

On January 1, 2007, we adopted the following new accounting pronouncements:

- FIN 48 Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*;
- FSP 13-2 FASB Staff Position 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction*;
- FAS 155 Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments*, *an amendment of FASB Statements No. 133 and 140*;
- FAS 157, *Fair Value Measurements*; and
- FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115.*

The adoption of FIN 48, FAS 155, FAS 157 and FAS 159 did not have any effect on our financial statements at the date of adoption. For additional information, see Note 11 (Income Taxes) and Note 16 (Fair Values of Assets and Liabilities) to Financial Statements.
Upon adoption of FSP 13-2, we recorded a cumulative effect of change in accounting principle to reduce the beginning balance of 2007 retained earnings by $71 million after tax ($115 million pre tax). This amount will be recognized back into income over the remaining terms of the affected leases.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are fundamental to understanding our results of operations and financial condition, because some accounting policies require that we use estimates and assumptions that may affect the value of our assets or liabilities and financial results. Three of these policies are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. These policies govern the allowance for credit losses, the valuation of residential MSRs and pension accounting. Management has reviewed and approved these critical

accounting policies and has discussed these policies with the Audit and Examination Committee. These policies are described in Financial Review Critical Accounting Policies and Note 1 (Summary of Significant Accounting Policies) to Financial Statements in our 2006 Form 10-K.

EARNINGS PERFORMANCE

NET INTEREST INCOME

Net interest income is the interest earned on debt securities, loans (including yield-related loan fees) and other interest-earning assets minus the interest paid for deposits and long-term and short-term debt. The net interest margin is the average yield on earning assets minus the average interest rate paid for deposits and our other sources of funding. Net interest income and the net interest margin are presented in the table on page 8 on a taxable-equivalent basis to consistently reflect income from taxable and tax-exempt loans and securities based on a 35% marginal tax rate.

Net interest income on a taxable-equivalent basis increased 3% to $5.04 billion in first quarter 2007 from $4.89 billion in first quarter 2006, primarily driven by a 1% growth in average earning assets and a 10 basis point increase in the net interest margin. The net interest margin was 4.95% in first quarter 2007, up from 4.85% in first quarter 2006. The completion of the sales of ARMs and lower-yielding investment securities last year reduced the earning asset growth rate year over year, but also helped boost net interest margin. The net interest margin continued to benefit from growth in core deposits.

Average earning assets increased to $410.8 billion in first quarter 2007 from $407.5 billion in first quarter 2006. Average loans increased to $321.4 billion in first quarter 2007 from $311.1 billion in first quarter 2006. Excluding real estate 1-4 family first mortgages, the loan category affected by the sales of ARMs last year, total average loans grew by $30.2 billion, or 13%, from first quarter 2006. Average mortgages held for sale decreased to $32.3 billion in first quarter 2007 from $39.5 billion in first quarter 2006. Average debt securities available for sale increased to $44.7 billion in first quarter 2007 from $43.5 billion in first quarter 2006.

Average core deposits are an important contributor to growth in net interest income and the net interest margin. This low-cost source of funding rose to $290.6 billion for first quarter 2007 from $257.5 billion a year ago and funded 90% and 83% of average loans at March 31, 2007 and 2006, respectively. Core deposits are noninterest-bearing deposits, interest-bearing checking, savings certificates, market rate and other savings, and certain foreign deposits (Eurodollar sweep balances). Core deposits now include those foreign deposits that were previously swept into non-deposit products. Including only the growth in these funds from the date of conversion to deposits, average core deposits grew 10% year over year. Total average retail core deposits, which exclude Wholesale Banking core deposits and retail mortgage escrow deposits, for first quarter 2007 grew $9.9 billion, or 5%, from a year ago. Average mortgage escrow deposits were $20.6 billion for first quarter 2007, up $5.1 billion from a year ago. Average savings certificates of deposits increased to $38.5 billion in first quarter 2007 from $28.7 billion in first quarter 2006 and average noninterest-bearing checking accounts and other core deposit categories (interest-bearing checking and market rate and other savings) increased to $234.3 billion in first quarter 2007 from $225.3 billion in first quarter 2006. Total average interest-bearing deposits increased to $221.0 billion in first quarter 2007 from $215.9 billion in first quarter 2006.

AVERAGE BALANCES, YIELDS AND RATES PAID (TAXABLE-EQUIVALENT BASIS) (1) (2)

					Quarter ended March 31,	
			2007			2006
(in millions)	**Average balance**	**Yields/ rates**	**Interest income/ expense**	Average balance	Yields/ rates	Interest income/ expense
EARNING ASSETS						
Federal funds sold, securities purchased under resale agreements and other short-term investments	**$ 5,867**	**5.15%**	**$ 75**	$ 5,192	4.21%	$ 54
Trading assets	**4,305**	**5.53**	**59**	6,099	4.61	69
Debt securities available for sale (3):						
Securities of U.S. Treasury and federal agencies	**753**	**4.31**	**8**	866	4.30	9
Securities of U.S. states and political subdivisions	**3,532**	**7.39**	**63**	3,106	8.13	60
Mortgage-backed securities:						
Federal agencies	**30,640**	**6.19**	**467**	27,718	5.92	406
Private collateralized mortgage obligations	**3,993**	**6.33**	**62**	6,562	6.46	104
Total mortgage-backed securities	**34,633**	**6.21**	**529**	34,280	6.02	510
Other debt securities (4)	**5,778**	**7.44**	**106**	5,280	7.86	104
Total debt securities available for sale (4)	**44,696**	**6.43**	**706**	43,532	6.36	683
Mortgages held for sale (5)	**32,343**	**6.55**	**530**	39,523	6.16	609
Loans held for sale	**794**	**7.82**	**15**	651	6.93	11
Loans:						
Commercial and commercial real estate:						
Commercial	**71,063**	**8.30**	**1,455**	62,769	7.71	1,195
Other real estate mortgage	**30,590**	**7.41**	**560**	28,686	7.01	497
Real estate construction	**15,892**	**8.01**	**314**	13,850	7.59	259
Lease financing	**5,503**	**5.74**	**79**	5,436	5.80	79
Total commercial and commercial real estate	**123,048**	**7.93**	**2,408**	110,741	7.42	2,030
Consumer:						
Real estate 1-4 family first mortgage	**54,444**	**7.33**	**995**	74,383	6.82	1,259
Real estate 1-4 family junior lien mortgage	**69,079**	**8.17**	**1,393**	59,972	7.65	1,131

Credit card	**14,557**	**13.55**	**493**	11,765	13.23	389
Other revolving credit and installment	**53,539**	**9.75**	**1,287**	48,329	9.39	1,120
Total consumer	**191,619**	**8.78**	**4,168**	194,449	8.10	3,899
Foreign	**6,762**	**11.54**	**192**	5,942	12.57	185
Total loans (5)	**321,429**	**8.51**	**6,768**	311,132	7.95	6,114
Other	**1,327**	**5.12**	**16**	1,389	4.62	16
Total earning assets	**$ 410,761**	**8.04**	**8,169**	$ 407,518	7.50	7,556
FUNDING SOURCES						
Deposits:						
Interest-bearing checking	**$ 4,615**	**3.25**	**37**	$ 4,069	2.23	22
Market rate and other savings	**140,934**	**2.77**	**963**	134,228	2.08	687
Savings certificates	**38,514**	**4.43**	**421**	28,718	3.45	245
Other time deposits	**9,312**	**5.13**	**118**	33,726	4.48	373
Deposits in foreign offices	**27,647**	**4.67**	**318**	15,152	4.16	155
Total interest-bearing deposits	**221,022**	**3.41**	**1,857**	215,893	2.78	1,482
Short-term borrowings	**11,498**	**4.78**	**136**	26,180	4.17	270
Long-term debt	**89,027**	**5.15**	**1,138**	81,686	4.49	910
Total interest-bearing liabilities	**321,547**	**3.94**	**3,131**	323,759	3.33	2,662
Portion of noninterest-bearing funding sources	**89,214**			83,759		
Total funding sources	**$ 410,761**	**3.09**	**3,131**	$ 407,518	2.65	2,662
Net interest margin and net interest income on a taxable-equivalent basis (6)		**4.95%**	**$ 5,038**		4.85%	$ 4,894
NONINTEREST-EARNING ASSETS						
Cash and due from banks	**$ 11,862**			$ 12,897		
Goodwill	**11,274**			10,963		
Other	**48,208**			43,817		
Total noninterest-earning assets	**$ 71,344**			$ 67,677		
NONINTEREST-BEARING FUNDING SOURCES						
Deposits	**$ 88,769**			$ 86,997		
Other liabilities	**25,474**			23,320		
Stockholders equity	**46,315**			41,119		
	(89,214)			(83,759)		

Noninterest-bearing funding sources used to fund earning assets		
Net noninterest-bearing funding sources	**$ 71,344**	$ 67,677
TOTAL ASSETS	**$ 482,105**	$ 475,195

(1) Our average prime rate was 8.25% and 7.43% for the quarters ended March 31, 2007 and 2006, respectively. The average three-month London Interbank Offered Rate (LIBOR) was 5.36% and 4.76% for the same quarters, respectively.
(2) Interest rates and amounts include the effects of hedge and risk management activities associated with the respective asset and liability categories.
(3) Yields are based on amortized cost balances computed on a settlement date basis.
(4) Includes certain preferred securities.
(5) Nonaccrual loans and related income are included in their respective loan categories.
(6)

Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities. The federal statutory tax rate was 35% for the periods presented.

NONINTEREST INCOME

(in millions)	Quarter ended March 31, 2007	2006	% Change
Service charges on deposit accounts	**$ 685**	$ 623	10%
Trust and investment fees:			
Trust, investment and IRA fees	**537**	491	9
Commissions and all other fees	**194**	172	13
Total trust and investment fees	**731**	663	10
Card fees	**470**	384	22
Other fees:			
Cash network fees	**45**	44	2
Charges and fees on loans	**238**	242	(2)
All other	**228**	202	13
Total other fees	**511**	488	5
Mortgage banking:			
Servicing income, net	**216**	81	167
Net gains on mortgage loan origination/sales activities	**495**	273	81
All other	**79**	61	30
Total mortgage banking	**790**	415	90
Operating leases	**192**	201	(4)
Insurance	**399**	364	10
Trading assets	**265**	134	98
Net gains (losses) on debt securities available for sale	**31**	(35)	
Net gains from equity investments	**97**	190	(49)
All other	**260**	258	1
Total	**$ 4,431**	$ 3,685	20

We earn trust, investment and IRA fees from managing and administering assets, including mutual funds, corporate trust, personal trust, employee benefit trust and agency assets. At March 31, 2007, these assets totaled $1.02 trillion, up 26% from $808 billion at March 31, 2006. Generally, trust, investment and IRA fees are based on a tiered scale relative to the market value of the assets that are managed, administered, or both. The increase in these fees in first quarter 2007 from a year ago was due to continued growth across all trust and investment management businesses.

We also receive commissions and other fees for providing services to full-service and discount brokerage customers. At March 31, 2007 and 2006, brokerage balances totaled $120 billion and $103 billion, respectively. Generally, these fees include transactional commissions, which are based on the number of transactions executed at the customer s direction, or asset-based fees, which are based on the market value of the customer s assets.
Card fees increased 22% from first quarter 2006, due to growth in distribution of debit and credit cards to our customers and increased usage. Purchase volume on these cards was up 19% from a year ago and average balances were up 20%.
Mortgage banking noninterest income was $790 million in first quarter 2007, compared with $415 million in the same period of 2006. Servicing fees, included in net servicing income, increased to $1.05 billion in first quarter 2007 from $747 million in first quarter 2006, due to growth in loans serviced for others. Our portfolio of loans serviced for others was $1.31 trillion

at March 31, 2007, up 41% from $931 billion at March 31, 2006. Servicing income also includes both changes in the fair value of MSRs during the period as well as changes in the value of derivatives (economic hedges) used to hedge the MSRs. Net servicing income for first quarter 2007 included a $34 million net MSRs valuation loss that was recorded to earnings ($11 million fair value loss and a $23 million economic hedging loss) and for first quarter 2006 included a $184 million net MSRs valuation loss ($522 million fair value gain less $706 million economic hedging loss).

Net gains on mortgage loan origination/sales activities were $495 million in first quarter 2007, up from $273 million in first quarter 2006. Residential real estate originations totaled $68 billion in first quarter 2007, up from $66 billion in first quarter 2006. Under FAS 159 we elected to account for new prime mortgages held for sale (MHFS) at fair value. These loans are initially measured at fair value, with subsequent changes in fair value recognized as a component of net gains on mortgage loan origination/sales activities. Prior to the adoption of FAS 159, these fair value gains would have been deferred until the sale of these loans. Included in the $495 million of net gains on mortgage loan origination/sales activities in first quarter 2007 was $229 million of gains from the initial measurement and subsequent changes to fair value of the prime MHFS that we elected to carry at fair value under FAS 159, which included $151 million related to loans that were originated and sold during first quarter 2007. (For additional detail, see Asset/Liability and Market Risk Management Mortgage Banking Interest Rate Risk, and Notes 1 (Significant Accounting Policies) and 16 (Fair Values of Assets and Liabilities) to Financial Statements.)

In first quarter 2007, we recognized $103 million of origination fees in mortgage loan originations/sales activities that would have previously been deferred and recognized at the time of sale. In first quarter 2007, we recognized $92 million in origination costs in noninterest expense that would have previously been deferred and recognized as a reduction of net gains on mortgage loan origination/sales activities at the time of sale. Separately included in net gains on mortgage loan origination/sales activities was a lower-of-cost-or-market write-down of $66 million for the remaining MHFS portfolio, primarily nonprime loans, which, as a consequence of our adoption of FAS 159, were valued separately from the prime MHFS. Prior to the adoption of FAS 159, these MHFS would have been valued together and the write-down would not have been required. The 1-4 family first mortgage unclosed pipeline was $57 billion at March 31, 2007, $48 billion at December 31, 2006, and $59 billion at March 31, 2006.

Income from trading assets increased to $265 million in first quarter 2007 from $134 million in first quarter 2006, due to higher capital markets income. Net gains on debt securities were $31 million in first quarter 2007, compared with net losses of $35 million in first quarter 2006. Net gains from equity investments were $97 million in first quarter 2007, compared with $190 million in first quarter 2006.

We routinely review our investment portfolios and recognize impairment write-downs based primarily on issuer-specific factors and results, and our intent to hold such securities. We also consider general economic and market conditions, including industries in which venture capital investments are made, and adverse changes affecting the availability of venture capital. We determine impairment based on all of the information available at the time of the assessment, with particular focus on the severity and duration of specific security impairments, but new information or economic developments in the future could result in recognition of additional impairment.

NONINTEREST EXPENSE

(in millions)	Quarter ended March 31, 2007	2006	% Change
Salaries	**$ 1,867**	$ 1,672	12%
Incentive compensation	**742**	668	11
Employee benefits	**665**	589	13
Equipment	**337**	335	1
Net occupancy	**365**	336	9
Operating leases	**153**	161	(5)
Outside professional services	**192**	193	(1)
Contract services	**118**	132	(11)
Travel and entertainment	**109**	130	(16)
Advertising and promotion	**91**	106	(14)
Outside data processing	**111**	104	7
Postage	**87**	81	7
Telecommunications	**81**	70	16
Insurance	**128**	76	68
Stationery and supplies	**53**	51	4
Operating losses	**87**	62	40
Security	**43**	43	
Core deposit intangibles	**26**	29	(10)
All other	**271**	236	15
Total	**$ 5,526**	$ 5,074	9

Noninterest expense increased 9% from the prior year due to continued investment in our businesses. In the last 12 months, we opened 104 retail banking stores, including 18 stores this quarter, and added 7,600 full-time equivalent (FTE) team members. Expenses in first quarter 2007 also included $50 million of stock option expense, $29 million of seasonal FICA expenses and $16 million of acquisition-related integration costs. In addition, expenses in first quarter 2007 included $92 million in origination costs that would have been deferred and recognized as a reduction of net gains on mortgage loan origination/sales activities at the time of sale, prior to the adoption of FAS 159.

INCOME TAX EXPENSE

On January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). Implementation of FIN 48 did not result in a cumulative effect adjustment to retained earnings. At January 1, 2007, the total amount of unrecognized tax benefits was $3.1 billion, of which $1.7 billion related to tax benefits that, if recognized, would impact the annual effective tax rate. During the quarter, $119 million of net tax benefits were recorded, primarily reflecting the resolution of certain outstanding federal income tax matters. (See Note 11 (Income Taxes) to Financial Statements.) Our effective income tax rate was 29.87% for first quarter 2007, down from 33.80% for first quarter 2006. We expect that FIN 48 will cause more volatility in our effective tax rate from quarter to quarter as we are now required to recognize tax positions in our financial statements based on the probability that such positions will effectively be sustained by taxing authorities, and to reassess those positions each quarter based on our evaluation of new information.

OPERATING SEGMENT RESULTS

We have three lines of business for management reporting: Community Banking, Wholesale Banking and Wells Fargo Financial. For a more complete description of our operating segments, including additional financial information and the underlying management accounting process, see Note 13 (Operating Segments) to Financial Statements.

Community Banking s net income increased 27% to $1.53 billion in first quarter 2007 from $1.21 billion in first quarter 2006, due in part to growth in retail banking and Wells Fargo Home Mortgage net income. Net interest income decreased 1% to $3.22 billion in first quarter 2007 from $3.26 billion in first quarter 2006, due to a decline in earning assets that resulted from the sales of ARMs at the end of first quarter 2006. The decline related to ARM sales was partially offset by an improvement in net interest margin of 21 basis points to 5.03% in first quarter 2007, despite pressures from the flat-to-inverted yield curve. Average loans were $180.8 billion in first quarter 2007, down 5% from $190.4 billion in first quarter 2006. Noninterest income in first quarter 2007 increased $704 million, or 33%, from $2.14 billion in first quarter 2006. The growth was due primarily to higher fee income related to mortgage and consumer loans, cards, brokerage and deposits. Noninterest expense increased $253 million, or 7%, primarily due to growth in personnel expenses. The provision for credit losses increased $117 million, or 62%, primarily due to higher losses in credit card and home equity lending. Income tax expense for first quarter 2007 decreased from a year ago due to a benefit from the resolution during the quarter of certain outstanding federal income tax matters for the periods prior to 2002.

Wholesale Banking s net income increased 13% to $598 million in first quarter 2007 from $528 million in first quarter 2006. Revenue was $2.05 billion in first quarter 2007, up 15% from $1.78 billion in first quarter 2006, due to strong loan and deposit growth and higher fee income. Average loans in first quarter 2007 increased 15% from a year ago. Average core deposits grew 64% from first quarter 2006, all in interest-bearing balances, reflecting a mix of organic growth and the conversions in 2006 of customer sweep accounts from off-balance sheet money market funds into deposits. Noninterest income increased $169 million in first quarter 2007 from a year ago due to higher trust and investment income, insurance revenue, commercial real estate brokerage fees and capital markets activity. Noninterest expense increased $145 million, mainly from higher personnel-related costs, including team member additions and higher incentive payments, along with higher expenses from acquisitions, expenses related to higher sales volumes and investments in new offices, businesses and systems.

Wells Fargo Financial s net income decreased to $114 million in first quarter 2007 from $280 million in first quarter 2006, due to the $127 million gain realized on the sale of our consumer lending business in Puerto Rico in first quarter 2006, as well as the higher provision for credit losses recorded in first quarter 2007. Total revenue declined 4% in first quarter 2007 to $1.32 billion, compared with $1.38 billion in first quarter 2006. Net interest income increased $71 million, or 8%, to $1.01 billion in first quarter 2007 from $934 million in first quarter 2006, due to continued growth in the real estate and auto loan portfolios. Average real estate secured receivables increased 20% to $23.6 billion and average auto finance receivables rose 23% to $27.6 billion. Noninterest expense increased $54 million, or 8%, in first quarter 2007 from $695 million in first quarter 2006, driven by normal annual increases in personnel costs, as well as staffing level increases in collections and other investments in business processes.

BALANCE SHEET ANALYSIS

SECURITIES AVAILABLE FOR SALE

Our securities available for sale portfolio consists of both debt and marketable equity securities. We hold debt securities available for sale primarily for liquidity, interest rate risk management and yield enhancement. Accordingly, this portfolio primarily includes very liquid, high-quality federal agency debt securities. At March 31, 2007, we held $44.7 billion of debt securities available for sale, compared with $41.8 billion at December 31, 2006, with net unrealized gains of $774 million and $722 million for the same periods, respectively. We also held $765 million of marketable equity securities available for sale at March 31, 2007, and $796 million at December 31, 2006, with net unrealized gains of $174 million and $204 million for the same periods, respectively.

The weighted-average expected maturity of debt securities available for sale was 5.3 years at March 31, 2007. Since 78% of this portfolio was mortgage-backed securities, the expected remaining maturity may differ from contractual maturity because borrowers may have the right to prepay obligations before the underlying mortgages mature.

The estimated effect of a 200 basis point increase or decrease in interest rates on the fair value and the expected remaining maturity of the mortgage-backed securities available for sale portfolio is shown below.

MORTGAGE-BACKED SECURITIES

(in billions)	Fair value	Net unrealized gain (loss)	Remaining maturity
At March 31, 2007	$ 34.8	$ 0.6	4.3 yrs.
At March 31, 2007, assuming a 200 basis point:			
Increase in interest rates	32.0	(2.2)	7.0 yrs.
Decrease in interest rates	35.4	1.2	1.1 yrs.

See Note 4 (Securities Available for Sale) to Financial Statements for securities available for sale by security type.

LOAN PORTFOLIO

A discussion of average loan balances is included in Earnings Performance Net Interest Income on page 7 and a comparative schedule of average loan balances is included in the table on page 8; quarter-end balances are in Note 5 (Loans and Allowance for Credit Losses) to Financial Statements.

Total loans at March 31, 2007, were $325.5 billion, up 6% from $306.7 billion at March 31, 2006. Real estate 1-4 family first mortgage loans decreased $10.1 billion to $56.0 billion at March 31, 2007, from $66.1 billion at March 31, 2006, due to the sales of lower-yielding ARMs last year. This decrease offset an increase of $8.4 billion in real estate 1-4 family junior lien mortgages to $69.5 billion from $61.1 billion for the same periods. Commercial and commercial real estate loans increased $12.9 billion, or 11%, from first quarter 2006. Mortgages held for sale decreased to $32.3 billion at March 31, 2007, from $43.5 billion a year ago.

DEPOSITS

(in millions)	**Mar. 31, 2007**	Dec. 31, 2006	Mar. 31, 2006
Noninterest-bearing	**$ 89,067**	$ 89,119	$ 88,701
Interest-bearing checking	**3,652**	3,540	3,459
Market rate and other savings	**146,911**	140,283	136,605
Savings certificates	**38,753**	37,282	29,377
Foreign deposits (1)	**18,086**	17,844	4,994
Core deposits	**296,469**	288,068	263,136
Other time deposits	**4,503**	13,819	33,317
Other foreign deposits	**10,185**	8,356	11,852
Total deposits	**$ 311,157**	$ 310,243	$ 308,305

(1) During 2006, certain customer accounts (largely Wholesale Banking) were converted to deposit balances in the form of Eurodollar sweep accounts from off-balance sheet money market funds and repurchase agreements. We include Eurodollar sweep balances in total core deposits.

Average core deposits increased $33.1 billion to $290.6 billion in first quarter 2007 from first quarter 2006, primarily due to growth in market rate and other savings, and savings certificates, along with growth in foreign deposits. Included in average core deposits were converted balances of $9,888 million, $8,888 million and $1,234 million for the quarter ended March 31, 2007, December 31, 2006, and March 31, 2006, respectively. Average core deposits increased 10% from first quarter 2006 and 9% (annualized) from fourth quarter 2006, not including the converted foreign balances.

OFF-BALANCE SHEET ARRANGEMENTS AND AGGREGATE CONTRACTUAL OBLIGATIONS

In the ordinary course of business, we engage in financial transactions that are not recorded in the balance sheet, or may be recorded in the balance sheet in amounts that are different than the full contract or notional amount of the transaction. We also enter into certain contractual obligations. For additional information on off-balance sheet arrangements and other contractual obligations see Financial Review Off-Balance Sheet Arrangements and Aggregate Contractual Obligations in our 2006 Form 10-K and Note 18 (Guarantees) to Financial Statements in this Report.

RISK MANAGEMENT

CREDIT RISK MANAGEMENT PROCESS

Our credit risk management process provides for decentralized management and accountability by our lines of business. Our overall credit process includes comprehensive credit policies, judgmental or statistical credit underwriting, frequent and detailed risk measurement and modeling, extensive credit training programs and a continual loan review and audit process. In addition, regulatory agencies review and perform detailed tests of our credit underwriting, loan administration and allowance processes.

Nonaccrual Loans and Other Assets

The table below shows the comparative data for nonaccrual loans and other assets. We generally place loans on nonaccrual status when:

- the full and timely collection of interest or principal becomes uncertain;
- they are 90 days (120 days with respect to real estate 1-4 family first and junior lien mortgages and auto loans) past due for interest or principal (unless both well-secured and in the process of collection); or
- part of the principal balance has been charged off.

Note 1 (Summary of Significant Accounting Policies) to Financial Statements in our 2006 Form 10-K describes our accounting policy for nonaccrual loans.

NONACCRUAL LOANS AND OTHER ASSETS

(in millions)	**Mar. 31, 2007**	Dec. 31, 2006	Mar. 31, 2006
Nonaccrual loans:			
Commercial and commercial real estate:			
Commercial	**$ 350**	$ 331	$ 256
Other real estate mortgage	**114**	105	163
Real estate construction	**82**	78	21
Lease financing	**31**	29	31
Total commercial and commercial real estate	**577**	543	471
Consumer:			
Real estate 1-4 family first mortgage (1)	**701**	688	508
Real estate 1-4 family junior lien mortgage	**233**	212	190
Other revolving credit and installment	**195**	180	188
Total consumer	**1,129**	1,080	886
Foreign	**46**	43	37
Total nonaccrual loans (2)	**1,752**	1,666	1,394
As a percentage of total loans	**0.54%**	0.52%	0.45%
Foreclosed assets:			
GNMA loans (3)	**381**	322	227
Other	**528**	423	228
Real estate and other nonaccrual investments (4)	**5**	5	
Total nonaccrual loans and other assets	**$ 2,666**	$ 2,416	$ 1,849
As a percentage of total loans	**0.82%**	0.76%	0.60%

(1) Includes nonaccrual mortgages held for sale.

(2) Includes impaired loans

of $251 million, $230 million and $137 million at March 31, 2007, December 31, 2006, and March 31, 2006, respectively. See Note 5 to Financial Statements in this Report and Note 6 (Loans and Allowance for Credit Losses) to Financial Statements in our 2006 Form 10-K for further information on impaired loans.

(3) Consistent with regulatory reporting requirements, foreclosed real estate securing GNMA loans is classified as nonperforming. These assets are fully collectible because the corresponding GNMA loans are insured by the FHA or guaranteed by the Department of Veterans Affairs.

(4) Includes real estate investments (contingent interest loans accounted for as investments) that would be

classified as
nonaccrual if
these assets
were recorded
as loans.

We expect that the amount of nonaccrual loans will change due to portfolio growth, portfolio seasoning, routine problem loan recognition and resolution through collections, sales or charge-offs. The performance of any one loan can be affected by external factors, such as economic or market conditions, or factors particular to a borrower, such as actions of a borrower s management.

Loans 90 Days or More Past Due and Still Accruing

Loans included in this category are 90 days or more past due as to interest or principal and still accruing, because they are (1) well-secured and in the process of collection or (2) real estate 1-4 family first mortgage loans or consumer loans exempt under regulatory rules from being classified as nonaccrual.

The total of loans 90 days or more past due and still accruing was $4,812 million, $5,073 million and $3,412 million at March 31, 2007, December 31, 2006, and March 31, 2006, respectively. At March 31, 2007, December 31, 2006, and March 31, 2006, the total included $3,683 million, $3,913 million and $2,680 million, respectively, in advances pursuant to our servicing agreements to GNMA mortgage pools whose repayments are insured by the FHA or guaranteed by the Department of Veterans Affairs.

LOANS 90 DAYS OR MORE PAST DUE AND STILL ACCRUING
(EXCLUDING INSURED/GUARANTEED GNMA ADVANCES)

(in millions)	**Mar. 31, 2007**	Dec. 31, 2006	Mar. 31, 2006
Commercial and commercial real estate:			
Commercial	**$ 29**	$ 15	$ 17
Other real estate mortgage	**4**	3	4
Real estate construction	**5**	3	13
Total commercial and commercial real estate	**38**	21	34
Consumer:			
Real estate 1-4 family first mortgage (1)	**159**	154	92
Real estate 1-4 family junior lien mortgage	**64**	63	47
Credit card	**272**	262	158
Other revolving credit and installment	**560**	616	364
Total consumer	**1,055**	1,095	661
Foreign	**36**	44	37
Total	**$ 1,129**	$ 1,160	$ 732

(1) Includes mortgages held for sale 90 days or more past due and still accruing.

Allowance for Credit Losses

The allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, is management s estimate of credit losses inherent in the loan portfolio at the balance sheet date. We assume that our allowance for credit losses as a percentage of charge-offs and nonaccrual loans will change at different points in time based on credit performance, loan mix and collateral values. The detail of the changes in the allowance for credit losses, including charge-offs and recoveries by loan category, is in Note 5 (Loans and Allowance for Credit Losses) to Financial Statements.

We consider the allowance for credit losses of $3.96 billion adequate to cover credit losses inherent in the loan portfolio, including unfunded credit commitments, at March 31, 2007. Given that the majority of our loan portfolio is

consumer loans, for which losses tend to emerge within a relatively short, predictable timeframe, and that a significant portion of the allowance for credit losses relates to estimated credit losses associated with consumer loans, management believes that the provision for credit losses for consumer loans, absent any significant credit event, will closely track the level of related net charge-offs. The process for determining the adequacy of the

allowance for credit losses is critical to our financial results. It requires difficult, subjective and complex judgments, as a result of the need to make estimates about the effect of matters that are uncertain. (See Financial Review Critical Accounting Policies Allowance for Credit Losses in our 2006 Form 10-K.) Therefore, we cannot provide assurance that, in any particular period, we will not have sizeable credit losses in relation to the amount reserved. We may need to significantly adjust the allowance for credit losses, considering current factors at the time, including economic or market conditions and ongoing internal and external examination processes. Our process for determining the adequacy of the allowance for credit losses is discussed in Financial Review Critical Accounting Policies Allowance for Credit Losses and Note 6 (Loans and Allowance for Credit Losses) to Financial Statements in our 2006 Form 10-K.

ASSET/LIABILITY AND MARKET RISK MANAGEMENT

Asset/liability management involves the evaluation, monitoring and management of interest rate risk, market risk, liquidity and funding. The Corporate Asset/Liability Management Committee (Corporate ALCO), which oversees these risks and reports periodically to the Finance Committee of the Board of Directors, consists of senior financial and business executives. Each of our principal business groups has individual asset/liability management committees and processes linked to the Corporate ALCO process.

Interest Rate Risk

Interest rate risk, which potentially can have a significant earnings impact, is an integral part of being a financial intermediary. We are subject to interest rate risk because:

- assets and liabilities may mature or reprice at different times (for example, if assets reprice faster than liabilities and interest rates are generally falling, earnings will initially decline);
- assets and liabilities may reprice at the same time but by different amounts (for example, when the general level of interest rates is falling, we may reduce rates paid on checking and savings deposit accounts by an amount that is less than the general decline in market interest rates);
- short-term and long-term market interest rates may change by different amounts (for example, the shape of the yield curve may affect new loan yields and funding costs differently); or
- the remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change (for example, if long-term mortgage interest rates decline sharply, mortgage-backed securities held in the securities available for sale portfolio may prepay significantly earlier than anticipated which could reduce portfolio income).

Interest rates may also have a direct or indirect effect on loan demand, credit losses, mortgage origination volume, the value of MSRs, the value of the pension liability and other sources of earnings.

We assess interest rate risk by comparing our most likely earnings plan with various earnings simulations using many interest rate scenarios that differ in the direction of interest rate changes, the degree of change over time, the speed of change and the projected shape of the yield curve. For example, as of March 31, 2007, our most recent simulation indicated estimated earnings at

risk is 1.8% of our most likely earnings plan over the next 12 months under a scenario in which the federal funds rate rises 175 basis points to 7.00% and the Constant Maturity Treasury bond yield rises 250 basis points to 7.25%, over the same 12-month period. Simulation estimates depend on, and will change with, the size and mix of our actual and projected balance sheet at the time of each simulation. Due to timing differences between the quarterly valuation of MSRs and the eventual impact of interest rates on mortgage banking volumes, earnings at risk in any particular quarter could be higher than the average earnings at risk over the 12-month simulation period, depending on the path of interest rates and on our hedging strategies for MSRs. See Mortgage Banking Interest Rate Risk below.

We use exchange-traded and over-the-counter interest rate derivatives to hedge our interest rate exposures. The credit risk amount and estimated net fair values of these derivatives as of March 31, 2007, and December 31, 2006, are presented in Note 20 (Derivatives) to Financial Statements. We use derivatives for asset/liability management in three ways:

- to convert a major portion of our long-term fixed-rate debt, which we issue to finance the Company, from fixed-rate payments to floating-rate payments by entering into receive-fixed swaps;
- to convert the cash flows from selected asset and/or liability instruments/portfolios from fixed-rate payments to floating-rate payments or vice versa; and
- to hedge our mortgage origination pipeline, funded mortgage loans and MSRs using interest rate swaps, swaptions, futures, forwards and options.

Mortgage Banking Interest Rate Risk

We originate, fund and service mortgage loans, which subjects us to various risks, including credit, liquidity and interest rate risks. We reduce unwanted credit and liquidity risks by selling or securitizing virtually all of the long-term fixed-rate mortgage loans we originate and most of the ARMs we originate. From time to time, we hold originated ARMs in our loan portfolio as an investment for our growing base of core deposits. We determine whether the loans will be held for investment or held for sale at the time of origination. We may subsequently change our intent to hold loans for investment and sell some or all of our ARMs as part of our corporate asset/liability management.

While credit and liquidity risks have historically been relatively low for mortgage banking activities, interest rate risk can be substantial. Changes in interest rates may potentially impact total origination and servicing fees, the value of our residential MSRs measured at fair value and the associated income and loss reflected in mortgage banking noninterest income, the income and expense associated with instruments (economic hedges) used to hedge changes in the fair value of MSRs, and the value of derivative loan commitments extended to mortgage applicants.

Interest rates impact the amount and timing of origination and servicing fees because consumer demand for new mortgages and the level of refinancing activity are sensitive to changes in mortgage interest rates. Typically, a decline in mortgage interest rates will lead to an increase in mortgage originations and fees and may also lead to an increase in servicing fee income, depending on the level of new loans added to the servicing portfolio and prepayments. Given the time it takes for consumer behavior to fully react to interest rate changes, as well as the time required for processing a new application, providing the commitment, and securitizing and selling the loan, interest rate changes will impact origination and servicing fees with a lag. The

amount and timing of the impact on origination and servicing fees will depend on the magnitude, speed and duration of the change in interest rates.

Under FAS 159, which we adopted January 1, 2007, we elected to measure MHFS at fair value prospectively for new prime MHFS originations for which an active secondary market and readily available market prices currently exist to reliably support fair value pricing models used for these loans. We also elected to remeasure at fair value certain of our other interests held related to residential loan sales and securitizations. We believe that the election for MHFS and other interests held (which are now hedged with free-standing derivatives (economic hedges) along with our MSRs) will reduce certain timing differences and better match changes in the value of these assets with changes in the value of derivatives used as economic hedges for these assets. Loan origination fees are recorded when earned, and related direct loan origination costs and fees are recognized when incurred.

Under FAS 156, which we adopted January 1, 2006, we have elected to use the fair value measurement method to initially measure and carry our residential MSRs, which represent substantially all of our MSRs. Under this method, the MSRs are recorded at fair value at the time we sell or securitize the related mortgage loans. The carrying value of MSRs reflects changes in fair value at the end of each quarter and changes are included in net servicing income, a component of mortgage banking noninterest income. If the fair value of the MSRs increases, income is recognized; if the fair value of the MSRs decreases, a loss is recognized. We use a dynamic and sophisticated model to estimate the fair value of our MSRs. While the valuation of MSRs can be highly subjective and involve complex judgments by management about matters that are inherently unpredictable, changes in interest rates influence a variety of assumptions included in the periodic valuation of MSRs. Assumptions affected include prepayment speed, expected returns and potential risks on the servicing asset portfolio, the value of escrow balances and other servicing valuation elements impacted by interest rates.

A decline in interest rates increases the propensity for refinancing, reduces the expected duration of the servicing portfolio and therefore reduces the estimated fair value of MSRs. This reduction in fair value causes a charge to income (net of any gains on free-standing derivatives (economic hedges) used to hedge MSRs). We may choose to not fully hedge all of the potential decline in the value of our MSRs resulting from a decline in interest rates because the potential increase in origination/servicing fees in that scenario provides a partial natural business hedge. In a rising rate period, when the MSRs may not be fully hedged with free-standing derivatives, the change in the fair value of the MSRs that can be recaptured into income will typically although not always exceed the losses on any free-standing derivatives hedging the MSRs. In first quarter 2007, the decrease in the fair value of our MSRs and the losses on free-standing derivatives used to hedge the MSRs totaled $34 million.

Hedging the various sources of interest rate risk in mortgage banking is a complex process that requires sophisticated modeling and constant monitoring. While we attempt to balance these various aspects of the mortgage business, there are several potential risks to earnings:

- MSRs valuation changes associated with interest rate changes are recorded in earnings immediately within the accounting period in which those interest rate changes occur, whereas the impact of those same changes in interest rates on origination and servicing fees occur with a lag and over time. Thus, the mortgage business could be protected from adverse changes in interest rates over a period of time on a cumulative basis but still

display large variations in income from one accounting period to the next.

The degree to which the natural business hedge offsets changes in MSRs valuations is imperfect, varies at different points in the interest rate cycle, and depends not just on the direction of interest rates but on the pattern of quarterly interest rate changes.

Origination volumes, the valuation of MSRs and hedging results and associated costs are also impacted by many factors. Such factors include the mix of new business between ARMs and fixed-rated mortgages, the relationship between short-term and long-term interest rates, the degree of volatility in interest rates, the relationship between mortgage interest rates and other interest rate markets, and other interest rate factors. Many of these factors are hard to predict and we may not be able to directly or perfectly hedge their effect.

While our hedging activities are designed to balance our mortgage banking interest rate risks, the financial instruments we use may not perfectly correlate with the values and income being hedged. For example, the change in the value of ARMs production held for sale from changes in mortgage interest rates may or may not be fully offset by Treasury and LIBOR index-based financial instruments used as economic hedges for such ARMs.

The total carrying value of our residential and commercial MSRs was $18.2 billion at March 31, 2007, and $18.0 billion at December 31, 2006. The weighted-average note rate on the owned servicing portfolio was 5.93% at March 31, 2007, and 5.92% at December 31, 2006. Our total MSRs were 1.39% of mortgage loans serviced for others at March 31, 2007, compared with 1.41% at December 31, 2006.

As part of our mortgage banking activities, we enter into commitments to fund residential mortgage loans at specified times in the future. A mortgage loan commitment is an interest rate lock that binds us to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock. These loan commitments are derivative loan commitments if the loans that will result from the exercise of the commitments will be held for sale. These derivative loan commitments are recognized at fair value in the balance sheet with changes in their fair values recorded as part of mortgage banking noninterest income. We record no value for the loan commitment at inception. Subsequent to inception, we recognize the fair value of the derivative loan commitment based on estimated changes in the fair value of the underlying loan that would result from the exercise of that commitment and on changes in the probability that the loan will not fund within the terms of the commitment (referred to as a fall-out factor). The value of that loan is affected primarily by changes in interest rates and the passage of time.

Outstanding derivative loan commitments expose us to the risk that the price of the loans underlying the commitments might decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. To minimize this risk, we utilize Treasury futures, forwards and options, Eurodollar futures and forward contracts as economic hedges against the potential decreases in the values of the loans that could result from the exercise of the loan commitments. We expect that these derivative financial instruments will experience changes in fair value that will either fully or partially offset the changes in fair value of the derivative loan commitments.

Market Risk - Trading Activities

From a market risk perspective, our net income is exposed to changes in interest rates, credit spreads, foreign exchange rates, equity and commodity prices and their implied volatilities. The primary purpose of our trading businesses is to accommodate customers in the management of their market price risks. Also, we take positions based on market expectations or to benefit from price differences between financial instruments and markets, subject to risk limits established and monitored by Corporate ALCO. All securities, foreign exchange transactions, commodity transactions and derivatives used in our trading businesses are carried at fair value. The Institutional Risk Committee establishes and monitors counterparty risk limits. The credit risk amount and estimated net fair value of all customer accommodation derivatives at March 31, 2007, and December 31, 2006, are included in Note 20 (Derivatives) to Financial Statements. Open, at risk positions for all trading business are monitored by Corporate ALCO.

The standardized approach for monitoring and reporting market risk for the trading activities is the value-at-risk (VAR) metrics complemented with factor analysis and stress testing. VAR measures the worst expected loss over a given time interval and within a given confidence interval. We measure and report daily VAR at a 99% confidence interval based on actual changes in rates and prices over the past 250 days. The analysis captures all financial instruments that are considered trading positions. The average one-day VAR throughout first quarter 2007 was $12 million, with a lower bound of $10 million and an upper bound of $14 million.

Market Risk - Equity Markets

We are directly and indirectly affected by changes in the equity markets. We make and manage direct equity investments in start-up businesses, emerging growth companies, management buy-outs, acquisitions and corporate recapitalizations. We also invest in non-affiliated funds that make similar private equity investments. These private equity investments are made within capital allocations approved by management and the Board of Directors (the Board). The Board reviews business developments, key risks and historical returns for the private equity investments at least annually. Management reviews these investments at least quarterly and assesses them for possible other-than-temporary impairment. For nonmarketable investments, the analysis is based on facts and circumstances of each individual investment and the expectations for that investment s cash flows and capital needs, the viability of its business model and our exit strategy. Private equity investments totaled $1.75 billion at March 31, 2007, and $1.67 billion at December 31, 2006.

We also have marketable equity securities in the available for sale investment portfolio, including securities relating to our venture capital activities. We manage these investments within capital risk limits approved by management and the Board and monitored by Corporate ALCO. Gains and losses on these securities are recognized in net income when realized and other-than-temporary impairment may be periodically recorded when identified. The initial indicator of impairment for marketable equity securities is a sustained decline in market price below the amount recorded for that investment. We consider a variety of factors such as: the length of time and the extent to which the market value has been less than cost; the issuer s financial condition, capital strength, and near-term prospects; any recent events specific to that issuer and economic conditions of its industry; and our investment horizon in relationship to an anticipated near-term recovery in the stock price, if any. The fair value of marketable equity

securities was $765 million and cost was $591 million at March 31, 2007, and $796 million and $592 million, respectively, at December 31, 2006.

Changes in equity market prices may also indirectly affect our net income (1) by affecting the value of third party assets under management and, hence, fee income, (2) by affecting particular borrowers, whose ability to repay principal and/or interest may be affected by the stock market, or (3) by affecting brokerage activity, related commission income and other business activities. Each business line monitors and manages these indirect risks.

Liquidity and Funding

The objective of effective liquidity management is to ensure that we can meet customer loan requests, customer deposit maturities/withdrawals and other cash commitments efficiently under both normal operating conditions and under unpredictable circumstances of industry or market stress. To achieve this objective, Corporate ALCO establishes and monitors liquidity guidelines that require sufficient asset-based liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding markets. We set these guidelines for both the consolidated balance sheet and for the Parent to ensure that the Parent is a source of strength for its regulated, deposit-taking banking subsidiaries.

Debt securities in the securities available for sale portfolio provide asset liquidity, in addition to the immediately liquid resources of cash and due from banks and federal funds sold, securities purchased under resale agreements and other short-term investments. Asset liquidity is further enhanced by our ability to sell or securitize loans in secondary markets through whole-loan sales and securitizations.

Core customer deposits have historically provided a sizeable source of relatively stable and low-cost funds. Additional funding is provided by long-term debt (including trust preferred securities), other foreign deposits and short-term borrowings (federal funds purchased, securities sold under repurchase agreements, commercial paper and other short-term borrowings).

Liquidity is also available through our ability to raise funds in a variety of domestic and international money and capital markets. We access capital markets for long-term funding by issuing registered debt, private placements and asset-backed secured funding. Rating agencies base their ratings on many quantitative and qualitative factors, including capital adequacy, liquidity, asset quality, business mix and level and quality of earnings. In September 2003, Moody s Investors Service rated Wells Fargo Bank, N.A. as Aaa, its highest investment grade, and rated the Company s senior debt as Aa1. In July 2005, Dominion Bond Rating Service raised the Company s senior debt rating to AA from AA(low). In February 2007, Standard & Poor s Ratings Services raised Wells Fargo Bank, N.A. s credit rating to AAA from AA+, and raised the Company s senior debt rating to AA+ from AA. Wells Fargo Bank, N.A. is now the only U.S. bank to have the highest possible credit rating from both Moody s and S&P.

Parent. Under SEC rules effective December 1, 2005, the Parent is classified as a well-known seasoned issuer, which allows it to file a registration statement that does not have a limit on issuance capacity. Well-known seasoned issuers generally include those companies with a public float of common equity of at least $700 million or those companies that have issued at least $1 billion in aggregate principal amount of non-convertible securities, other than common

equity, in the last three years. However, the Parent s ability to issue debt and other securities under a registration statement filed with the SEC under these new rules is limited by the debt issuance authority granted by the Board. The Parent is currently authorized by the Board to issue $25 billion in outstanding short-term debt and $95 billion in outstanding long-term debt, subject to a total outstanding debt limit of $110 billion. In June 2006, the Parent s registration statement with the SEC for issuance of senior and subordinated notes, preferred stock and other securities became effective. During first quarter 2007, the Parent issued a total of $9.2 billion of registered senior notes. We used the proceeds from securities issued in first quarter 2007 for general corporate purposes and expect that the proceeds in the future will also be used for general corporate purposes. The Parent also issues commercial paper from time to time, subject to its short-term debt limit.

Wells Fargo Bank, N.A. Wells Fargo Bank, N.A. is authorized by its board of directors to issue $20 billion in outstanding short-term debt and $40 billion in outstanding long-term debt. In March 2003, Wells Fargo Bank, N.A. established a $50 billion bank note program under which, subject to any other debt outstanding under the limits described above, it may issue $20 billion in outstanding short-term senior notes and $30 billion in long-term senior notes. Securities are issued under this program as private placements in accordance with Office of the Comptroller of the Currency (OCC) regulations. Wells Fargo Bank, N.A. did not issue any debt in first quarter 2007.

Wells Fargo Financial. In January 2006, Wells Fargo Financial Canada Corporation (WFFCC), a wholly-owned Canadian subsidiary of Wells Fargo Financial, Inc. (WFFI), qualified for distribution with the provincial securities exchanges in Canada $7.0 billion (Canadian) of issuance authority. WFFI did not issue any debt in first quarter 2007. At March 31, 2007, the remaining issuance capacity for WFFCC was $5.4 billion (Canadian).

CAPITAL MANAGEMENT

We have an active program for managing stockholder capital. We use capital to fund organic growth, acquire banks and other financial services companies, pay dividends and repurchase our shares. Our objective is to produce above-market long-term returns by opportunistically using capital when returns are perceived to be high and issuing/accumulating capital when such costs are perceived to be low.

From time to time the Board of Directors authorizes the Company to repurchase shares of our common stock. Although we announce when the Board authorizes share repurchases, we typically do not give any public notice before we repurchase our shares. Various factors determine the amount and timing of our share repurchases, including our capital requirements, the number of shares we expect to issue for acquisitions and employee benefit plans, market conditions (including the trading price of our stock), and legal considerations. These factors can change at any time, and there can be no assurance as to the number of shares we will repurchase or when we will repurchase them. Historically, our policy has been to repurchase shares under the safe harbor conditions of Rule 10b-18 of the Exchange Act including a limitation on the daily volume of repurchases. Rule 10b-18 imposes an additional daily volume limitation on share repurchases during a pending merger or acquisition in which shares of our stock will constitute some or all of the

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