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EDITED TRANSCRIPT

WFC - Q1 2012 Wells Fargo Earnings Conference Call

EVENT DATE/TIME: APRIL 13, 2012 / 2:00PM GMT

OVERVIEW:

WFC reported 1Q12 revenues of $21.6b and earnings of $4.2b or $0.75 per share.

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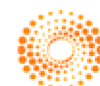

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PRESENTATION

Operator

Good morning. My name is Regina and I will be your conference operator today. At this time I would like to welcome everyone to the Wells Fargo first-quarter earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks will be a question-and-answer session. (Operator Instructions)

I would now like to turn the call over to Jim Rowe, Director of Investor Relations. Mr. Rowe, you may begin your conference.

Jim Rowe - *Wells Fargo & Company - Director IR*

Thank you, Regina, and good morning, everyone. Thank you for joining our call today, during which our Chairman and CEO John Stumpf and our CFO Tim Sloan will review first-quarter results and answer your questions.

Before we get started I would like to remind you that our first-quarter earnings release and quarterly supplement are available on our website. I would also like to caution you that we may make forward-looking statements during today's call that are subject to risks and uncertainties. Factors that may cause actual results to differ materially from expectations are detailed in our SEC filings, including the Form 8-K filed today containing our earnings release and quarterly supplement.

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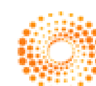

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Information about any non-GAAP financial measures referenced, including a reconciliation of those measures to GAAP measures, can also be found in our SEC filings, in the earnings release, and in the quarterly supplement available on our website at WellsFargo.com.

I will now turn the call over to our Chairman and CEO, John Stumpf.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Thank you, Jim, and good morning, everyone, and thanks for joining us. Our outstanding results for the first quarter demonstrate the strength of our franchise and the benefit of our diversified business model. Our ability to meet our customers' financial needs throughout our geographic footprint and broadly diversified businesses is clearly reflected in our results.

Let me quickly review some of the highlights of the first quarter. We grew revenue to $21.6 billion, up 6% from a year ago. We generated net income after tax up 13% and EPS up 12% from a year ago. Pre-tax pre-provision profits increased 14% from a year ago.

We had positive operating leverage, and our expense efficiency ratio improved by 250 basis points from a year ago. We grew our retail banking cross-sell ratio to a record 5.98 products per household.

Credit quality continued to improve, with our charge-off ratio declining to 1.25%, the lowest level since 2007. Our profitability ratios reflect these strong results, with a return on assets growing to 1.31%, up 8 basis points from a year ago, the highest it's been in four years. Our return on equity increased to 12.14%, up 16 basis points from just a year ago.

We continue to grow capital, with our estimated Tier 1 common equity ratio under Basel III increasing to 7.81%. We are extremely pleased that during the first quarter we were able to reward our shareholders by increasing our dividend for the second consecutive year with an 83% increase to $0.22 per share per quarter.

Wells Fargo's performance has benefited from our diversified business model and the improvements in the economy. We remain focused on our commitment to do all we can to help customers and the overall economy.

We are helping homeowners stay in their homes, with over 740,000 active trial or completed mortgage modifications since the beginning of 2009. We have also helped nearly 5.6 million customers secure new low-rate loans for home purchases or refinancing since the beginning of 2009.

In the first quarter we successfully completed integrating the largest and most complex bank merger in our nation's history. It took us three years, but we did it the right way, on time, and under budget.

We believe our strong results this quarter are just the beginning of our ability to capitalize on all of the tremendous growth opportunities ahead of us as we move forward as one Wells Fargo serving our 70 million customers coast-to-coast. Now Tim, our CFO, will provide more details on our financial results.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Thanks, John, and good morning, everyone. My remarks will follow the presentation included in the first half of the quarterly supplement, starting on page 2, and then John and I will take your questions.

As John highlighted, we achieved very strong first-quarter results with record earnings of $4.2 billion, up 3% from the fourth quarter and up 13% from a year ago.

Earnings per share were a record $0.75, up 3% from last quarter and 12% from a year ago. This is our ninth consecutive quarter of EPS growth. That is real consistency.

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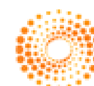

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Our ability to grow our bottom line consistently during a time when the industry has faced many challenges reflects the underlying strength and the benefit of our diversified business model. This quarter was no different. As slide 3 shows, we have a diversified loan portfolio, balanced spread and fee income, and our sources of non-interest income are well diversified.

Let me start by highlighting some of the key drivers of our results this quarter, and I will add more detail later in my remarks. While total loans declined this quarter, our core loan portfolio, which excludes the planned runoff from the liquidating portfolio, was up $1 billion dollars from the fourth quarter. Our securities portfolio grew $7.7 billion, and we continue to deploy cash in longer-term investments and benefit from continued strong deposit growth, with deposit balances up $10.2 billion.

Let's turn to the income statement. Revenue grew by $1 billion or 5% from the fourth quarter, on strong mortgage results and fee growth throughout our diversified businesses, while net interest income was stable. As expected our expenses remained elevated in this quarter, but we generated positive operating leverage. We expect second-quarter expenses to decline by $500 million to $700 million and that our quarterly expenses will continue to decline over the remainder of the year.

Now let me cover our results in more detail. As shown on page 6, period-end loans were down $3.1 billion from the fourth quarter, as we continue to reduce the size of our liquidating portfolio. Excluding the runoff of $4.1 billion of liquidating loans, our core loan portfolio grew by $1 billion.

Commercial loans grew $299 million as growth in C&I was partially offset by lower Commercial Real Estate and foreign loans. Loan growth benefited from $858 million of loans acquired from Burdale Capital Finance during the quarter.

As we head into the second quarter we have a nice tailwind for increasing loans with the announced acquisition of BNP Paribas's North American energy lending business, which includes approximately $3.9 billion of loans outstanding and is expected to close later this month.

Consumer loans declined $3.4 billion from the fourth quarter, as growth in our auto and our private student lending portfolios was offset by lower junior lien mortgages and seasonally lower credit card balances. Average loan balances were flat linked-quarter, but we had growth in many portfolios. We believe we are well positioned to grow loans during the rest of the year.

We had strong deposit growth with average core deposits up $5.6 billion from the fourth quarter and up $73.7 billion, or 9% from a year ago. Core deposits were 113% of average loans.

Average core checking and savings deposits were up 12% from a year ago and were 93% of core deposits. Consumer checking accounts were up a net 2.5% from a year ago. We have successfully grown deposits while reducing our deposit cost for six consecutive quarters. Deposit costs in the first quarter were 20 basis points, down 2 basis points from the fourth quarter and down 10 basis points from a year ago.

Tax-equivalent net interest income was stable from the fourth quarter, with average earning assets essentially unchanged; and the NIM was up 2 basis points. That said, we expect continued pressure on our NIM as a result of the current interest rate environment.

The benefit of disciplined deposit pricing, with interest-bearing deposit costs down 3 basis points in the quarter, and the redeployment of short-term investments into longer-term securities, largely offset the expected runoff of higher-yielding loans and investments during the quarter.

Noninterest income increased $1 billion from the fourth quarter, up 11%. This growth was broad-based and reflected very strong mortgage results. Mortgage banking revenue increased $506 million, up 21% from the fourth quarter, driven by strong originations and higher margins.

Mortgage originations were $129 billion in the first quarter, up 8% from the fourth quarter. Only 15% of our origination volume this quarter was from HARP.

The unclosed mortgage pipeline was solid at $79 billion at quarter-end. Mortgage results included a $343 million reduction in the value of MSRs to incorporate a higher discount rate.

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Market-sensitive revenues were up $458 million from the fourth quarter and included $364 million in equity gains. These equity gains were up $303 million from last quarter, but were in line with our quarterly average last year of $370 million.

Trading gains increased $210 million from the last quarter, reflecting the benefit from $109 million of higher deferred compensation plan investment results, which is offset in expense, and stronger core customer accommodation trading. Trust and investment fees increased $181 million, up 7% from the fourth quarter, from higher retail brokerage transaction activity and asset-based fees.

Turning to expenses, recall that we indicated last quarter that costs will remain elevated in the first quarter. Non-interest expense increased $485 million from the fourth quarter, driven primarily by two factors -- higher personnel expenses and operating losses.

Now let me walk you through the first-quarter expenses in more detail on page 11. Employee compensation expense increased for three primary reasons.

First, we had $476 million of seasonally higher employee benefit expenses from higher payroll taxes and 401(k) matching. Second, we had $120 million of higher deferred compensation expenses, which were offset in revenue. And finally, we had $166 million of higher commission and incentive compensation expenses driven by revenue growth in mortgage, retail brokerage, and insurance. In addition, we had $314 million of higher operating losses primarily due to additional litigation accruals for various legal matters.

Offsetting these increases was $262 million of lower merger integration and Compass severance expenses, and $329 million in lower expenses from seasonally higher fourth-quarter levels in equipment and foreclosed asset expense, and other benefits including Compass cost saves.

As shown on page 12, we expect second-quarter expenses to decline by $500 million to $700, million driven by the elimination of merger integration expenses and lower personnel expense. And we expect expenses to continue to decline over the remainder of the year.

As you will recall, when we first provided you detail on our expense initiative in the second quarter of last year, we stated that we expected our fourth-quarter 2012 expenses to be within the range of $10.75 billion to $11.25 billion with a target of $11 billion. This target assumed a certain level of revenue growth, which we now expect to be stronger than we originally assumed -- obviously, a very good thing. Because of expected higher revenue we are now targeting fourth-quarter 2012 expenses to be $11.25 billion.

We have continued to make progress on reducing expenses through our Compass expense initiative. For example, non-customer-facing team members and contractors in high-cost geographies are down 11% from the beginning of 2011, and we have reduced technology expense by 3% despite meaningful growth in IT-related volumes.

Turning briefly to our segment results, starting on page 13, Community Banking earned $2.3 billion in the first quarter, benefiting from strong mortgage results. Retail Banking sales continued to generate strong growth, with core product sales up 9% from a year ago. Retail Banking cross-sell grew to 5.98 products per household, up from 5.76 a year ago.

Cross-sell growth occurred throughout the franchise. But with the East's cross-sell 86 basis points lower than the West, we have plenty of opportunity to earn more business from our customers in the East.

Credit card penetration in our Retail Banking households continued to increase to 30%, up from 27% a year ago. We generated record consumer auto originations in the first quarter of $6 billion, up 25% from fourth quarter and 10% from a year ago.

Wholesale Banking earned $1.9 billion in the first quarter, up $232 million or 14% from the fourth quarter. This strong bottom-line growth reflects record revenue of $6 billion, up 11% from the fourth quarter, which was broad-based across our diversified commercial businesses.

Wholesale Banking also generated record pre-tax pre-provision profit and positive operating leverage, with the expense efficiency ratio improving to 50.6% in the first quarter compared with 54.2% in the fourth quarter. Loan growth was broad-based, reflecting new and existing customer growth and our ability to capitalize on acquisition opportunities in this environment.

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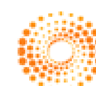

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For example, we have grown our Commercial Banking portfolio for 20 consecutive months from new originations and increased line utilization from our middle-market customers. During the past year, we have completed $4.8 billion of loan portfolio acquisitions; and this quarter we announced the acquisition of $3.9 billion in loans outstanding from BNP Paribas, which we expect to close later this month.

Wealth, Brokerage and Retirement earned $296 million. Excluding the fourth quarter's gain on the sale of H.D. Vest of $153 million, earnings would have increased 34% from last quarter.

Revenue increased 1% from the fourth quarter. Again, excluding the fourth-quarter H.D. Vest gain, revenue grew 6% from last quarter. This growth was driven by higher asset-based fees, strong brokerage transaction revenue, and securities gains in the brokerage business.

Managed account assets were up $26 billion (sic - see slide 16) or 10% from the fourth quarter driven by strong net flows and market performance. First-quarter net flows reflect recovery to levels last seen in the second quarter of 2011. Our continued focus on helping customers succeed financially drove cross-sell to 10.16, up from 9.85 a year ago.

Credit quality continued to improve this quarter as shown on page 16. Net charge-offs were down $245 million from the fourth quarter and were 1.25% of average loans, down 48 basis points from a year ago and the lowest charge-off rate since 2007. Provision expense was $2 billion, including a $400 million reserve release in the first quarter. Absent significant deterioration in the economy, we continue to expect future reserve releases in 2012.

Non-accrual loans increased $722 million from the fourth quarter. This entire increase was the result of the reclassification of $1.7 billion of performing junior lien loans and lines to non-accrual status in accordance with interagency guidance issued to the industry this quarter, related to junior liens behind a delinquent senior lien loan. Only 12% of these reclassified junior liens were 30 days or more past due.

This policy change had an immaterial impact on our earnings since the loans were already considered in our loan-loss allowance and the related interest income impact was minimal. Absent this policy change, non-accrual loans would have been down $948 million from the fourth quarter with declines in all loan categories. This continues the trend of improvement that started in the fourth quarter of 2010.

Loans 90 days or more past due were down $412 million or 20% from the fourth quarter, with declines in both commercial and consumer portfolios. Early-stage consumer loan delinquency balances and rates also improved from the fourth quarter, driven by seasonality, but are also significantly better than a year ago as portfolio performance continued to improve.

We serviced $1.8 trillion of residential mortgages. We like the cross-sell opportunities this provides, and it also positions us well to benefit from refinance waves like we are experiencing now, since existing customers usually give us the first chance when they refinance.

On page 18 we highlight why we believe our servicing portfolio is the best in the industry. 71% of our servicing portfolio is serviced for the agency; only 5% are private securitizations, and 79% of those were prime at origination and over half were originated prior to 2006.

Most of the loans we securitize were jumbo loans. We do not have private-label option ARM securities, nor do we have a significant amount of home equity securitizations.

Reflecting the quality of our servicing portfolio, our delinquency and foreclosure rate was nearly 400 basis points lower than the industry average, excluding Wells Fargo, based on the most recent publicly available data. Our total delinquency and foreclosure rate was 6.89% in the first quarter, down from 7.22% a year ago and from a peak of 8.96% in the fourth quarter of 2009.

The repurchase reserve increased by $118 million in the first quarter. Total repurchase demands were down $154 million from the fourth quarter, down approximately 25% from a year ago and down 57% from the peak in the second quarter of 2010.

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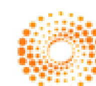

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As shown on page 20, our capital position continued to improve, with our Tier 1 common equity ratio increasing to 9.95% and our estimated Tier 1 common equity ratio under current Basel III proposals growing to 7.81%, up 31 basis points from the fourth quarter. We have been able to grow our capital ratios while rewarding our shareholders by increasing our first-quarter dividend by 83%.

We purchased 7.6 million shares in the first quarter, primarily through a forward repurchase transaction entered into during the fourth quarter. We called $875 million of 6.38% trust preferred securities in the first quarter, which we redeemed today.

In summary, our diversified business model focused on basic banking generated another quarter of outstanding results, with record earnings, robust revenue, and pretax pre-provision growth, positive operating leverage, and continued improvement in credit quality. These results drove our ROA to 1.31% and increased our ROE to 12.14%, and our capital ratios continue to grow.

We increased our dividend rate to $0.22 per share, which we paid to our shareholders in the first quarter. We are well positioned to continue to grow, ending the quarter with a strong mortgage pipeline, and we are focused on capitalizing on acquisition opportunities, increasing our cross-sell, growing our loans and deposits, and reducing our expenses.

We look forward to sharing more details on our growth opportunities at our Investor Day next month. I will now open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Joe Morford, RBC Capital Markets.

Joe Morford - *RBC Capital Markets - Analyst*

Good morning, everyone. I wondered, Tim, could you give us a sense of the yield you are getting on some of these loan portfolio purchases you have made to date and how additive they are to the margin? Also, are you still seeing a good pipeline of opportunities? Just how competitive is the market now for these acquisitions?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Sure, good question. When you look at the yields that we received our commercial real estate loans that we bought last year in a number of transactions, they were more or less consistent with the rest of the portfolio. These were generally high-quality loans.

As you recall, a good portion of those were customers that we already knew. So I would say that it was consistent with those yields.

Then in terms of the Burdale Capital Finance portfolio, again it was pretty consistent, high-quality stuff with the Capital Finance portfolio.

In terms of how competitive the market is, I wouldn't say that it has really changed a whole lot. In any situation that we are seeing that we are interested in, there is at least a handful of competitors. And everybody wants to grow, so you've got to pay an appropriate price.

Joe Morford - *RBC Capital Markets - Analyst*

Okay. Then just one other is you mentioned HARP accounted for around 15% of its origination volume in first quarter. Do you see that rising much and having a greater impact on your business? And beyond that, just in general, what are your thoughts on the current strength of the housing market?

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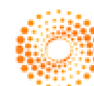

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John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Well, did you want to --?

Yes, I want to tell you on the housing side, we are seeing improvement and we have been seeing that for some time. But we are seeing it more -- and it depends on the region of the country, strength, of course, and the different price points.

But when you have the dynamics of higher rental rates and lower home values at great financing rates, there is a point in time where the market is going to clear and you are going to see improvement. I think we are getting very close to that tipping point, and we have seen it in some of the markets.

In some markets like Northern California, Texas, the District of Columbia, in that area, stronger. Other areas would be a bit weaker, but we are seeing improvement there.

With respect to HARP, you're right; 15% of our volume was HARP. But we had a pretty good pipeline there. HARP, too, is an opportunity for very high loan-to-value -- or, quote unquote, underwater from an equity perspective -- current borrowers to refinance, and we are going to see more volume in that.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

And, John, maybe let me just add on to that, and that is that -- Joe, most of the volume that we saw from HARP was from HARP 1 and, again, about 15% of the total fundings in the first quarter. So we are just beginning to see the results of HARP 2 start to kick in. How long that continues we don't know, but right now the mortgage business is very good for us.

Joe Morford - *RBC Capital Markets - Analyst*

That's great. Thanks so much.

Operator

John McDonald, Sanford Bernstein.

John McDonald - *Sanford C. Bernstein - Analyst*

Hi, good morning. Was wondering about if you could give us a little color on your approach to share buybacks. Are you purely price-sensitive, or does it depend on what other uses of capital you have? Could you give us some color on how you think about the buybacks?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Sure. Thank you, John. You know, we have been very consistent with our view of rewarding shareholders. First of all, those of you who know us well know that we are very shareholder friendly and centric.

There is a number of dynamics that are going on right now. We are still buying back TruPS. We have increased our dividend by 83%. We are going to -- we have approval to do more repurchase this year than last year.

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We are very happy we went through the CCAR with no objections to our plan. And we want to have enough capital around so we can grow this Company, and we believe we are a growth company. So we will buy back when it is opportunistic for us to do that. But again, we have all of the other issues in play; and I think balance, consistency, and a friendly view around rewarding our stockholders -- who again we have great emphasis on that -- will really dictate what we do.

John McDonald - *Sanford C. Bernstein - Analyst*

Okay. Thank you, John. A question for Tim on expenses. Tim, any color on the pace of expense decline throughout the year from the second quarter, third and fourth? Does it pick up steam or do you envision that spread evenly throughout the quarters as we go towards that fourth-quarter goal?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, John, good question. Again, nothing has really fundamentally changed as we think about expenses from the prior quarter. We are committed to reducing our expenses and improving operating efficiency.

Again, we feel good about the $500 million to $700 million; but in terms of specifics as it relates to third and fourth quarter, obviously to get down to the $11.25 billion target that we set, it is going to have to be spread pretty evenly. But again we feel confident in our ability to do it and are looking forward to it.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Yes, John, I would like to add one thing to that. We are absolutely committed. But if we get to the fourth quarter and if for whatever reason there is all kinds of revenue available in a certain business or a number of businesses, we are not going to be slavish to any one number.

We are going to do the one thing right thing for the stockholder, and we are going to make sure that we continue to produce the kind of results you would want us to do. But we are committed to that number. We have plans in place. We know we are going to get it, but we are not going to be slavish to it.

John McDonald - *Sanford C. Bernstein - Analyst*

Understood. Okay, thank you. Then, Tim, is there any Compass savings that go beyond the fourth quarter? Are there savings that you'd be working on for the year 2013 out of Compass (multiple speakers)?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Oh, sure. Absolutely. I think that is a really important point. It is not as if we put together an expense focus, we're going to get to the fourth quarter and just stop being focused on improving operating efficiencies. I think that post the merger integration, it really gives us an opportunity to focus on operating leverage and improved efficiencies.

And we will continue to do that into '14, '15, and '16. We're not going to stop.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Absolutely. Because the key here is if we're more efficient on things that customers don't want to pay for, we can add salespeople, add more value to things that customers want to have. So we can compete for revenues and grow our franchise and do all the things that add value.

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John McDonald - *Sanford C. Bernstein - Analyst*

Okay. Then just a question on Basel III for Tim, I guess. Tim, your pro forma ratio of risk-weighted assets to total assets under Basel III is high. It seems like almost 100%.

Where is the biggest inflation of your risk-weighted assets coming from under Basel III? Is it the sub-investment-grade securities that get hit pretty hard? And is there an opportunity to mitigate that over time?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, I don't know if I would describe it as an inflation of our numbers. We go through what we think is an appropriate review of all of our assets and try to compare them to what we think the Basel III rules are going to be.

Others -- it may be where you are going, that others have different ratios. I don't know how anybody else is doing it. I know how we are doing it, and I think we're doing it in an appropriate way.

Having said that, obviously, because it is an important ratio we are going to look at our risk-weighted assets and make sure that we are getting the good return on all of our risk-weighted assets as we roll into Basel III. But I think the other important point is that, regardless of what the risk-weighted asset level is, capital is not an issue for us. Right?

We are at 7.81%. The minimum requirement for us we know is 7%. Maybe there is going to be a SIF buffer, maybe not. So we are not concerned about -- we are not overly concerned about that ratio, but we spend a lot of time making sure that it is calculated correctly.

John McDonald - *Sanford C. Bernstein - Analyst*

Okay. Does the treatment of MSR under Basel III affect at all how you decide or not decide to grow the business? Or will decisions to grow mortgage servicing or not be independent of capital treatment? I just want to get that; if that's a factor in how you look at the MSR and the business?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

You know, John, first of all, we love the mortgage business. We love it because our customers love it. Two-thirds of our customers are in the mortgage business. And I don't know how you can be in the consumer banking business if you are not in the mortgage business. Along with checking accounts and mortgages, that drives a lot of the household acquisition.

And once a customer does a mortgage with us, great things happen. They stay longer; they buy more products. So that's great.

And in our mortgage business, specifically around the MSR, as you know it is a balanced business. Origination on one side and servicing on the other side, and they move in opposite directions with what happens to interest rates.

Yes, there is an element of the MSR that we think is not -- we don't agree with the treatment under Basel because we think it is as good an asset as you can have. But that being said, if rates do rise and the mortgage servicing asset goes up in value and less of it gets counted for capital or there is a bigger exclusion, other great things happen in the Company. There's offsets and there's balances.

We are not going to let one ratio or one issue like that drive us away from the business that we think is a good thing for customers, for our stockholders, for everyone involved here. It is not that we are oblivious to it, and we are looking for other ways to mitigate it, and we spent a lot of time on that.

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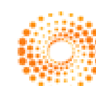

But it is just not a deal-stopper around here. We love the business.

John McDonald - *Sanford C. Bernstein - Analyst*

Got it. Okay. That's helpful. Thanks, John.

Operator

Betsy Graseck, Morgan Stanley.

Betsy Graseck - *Morgan Stanley - Analyst*

Hey, good morning. You mentioned that 15% of your total fundings were HARP. Could you just give us a sense of the application volumes that have been HARP-related?

Then I just had a follow-up question on the ultimate approval of HARP relative to other apps that you have been seeing.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, the application volumes again were about 15%. HARP 2 was kind of rolled out in the middle of the quarter, and so those applications are up a bit; but I wouldn't describe -- it wasn't a significant portion of the first-quarter volume. Our expectation is they are probably going to increase.

But again, we think it's a good program. We think it will be helpful, but it is in its early stages. But obviously given the servicing book that we have, we are going to be a large part of that program.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

And, Betsy, one thing that is a little different about that, you actually have to -- we spend a little more time marketing. You have to actually go and talk with people and help them understand how they qualify and how they fit into the program.

And we are doing that. We have feet on the street. We have people available. We have a big retail distribution.

And we think it is -- first of all, we think it is a good thing. It is great to see people who have made their payments every month, even though they are under water or hugely under water. And now to be able to help them put a few hundred dollars extra in their pocket every month, that is terrific.

Betsy Graseck - *Morgan Stanley - Analyst*

So a little bit more expensive to get the refi in, obviously. So I guess the question is, what has the approval rate been? What do you think the approval rate is likely to be, relative to other refis? Non-HARP, just refi.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Betsy, that is a fair question, but I think we are too new to rate into the HARP 2 program. I think over the next few months we will have a better appreciation for that, but I wouldn't want to guess on that one.

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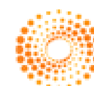

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Betsy Graseck - *Morgan Stanley - Analyst*

Okay. Then just my other question had to do with loan growth. I know that that is a priority for you. Given the push/pull in the portfolio where you've got some of the portfolio obviously is still in run-off, do you feel that you can drive net loan growth over the next year or so? Or you have to wait for that run-off portfolio to really shrink a little bit more dramatically before you can anticipate that?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

No, we think we can continue to drive the growth. You saw in the third and the fourth quarter of last year that we saw point-to-point growth in both quarters. This quarter we were down a bit, but we feel good about our ability to grow loans organically.

As well and in addition, as we mentioned, we have been active from an acquisition standpoint. So any quarter might be a little bit up, a little bit down; but over time we feel confident about our ability to grow the loan portfolio. And we don't think we are going to need to wait until the liquidating portfolio just declines to a small number.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Betsy, the other thing is in the first quarter there is some seasonality. So we typically see card balances coming down in the first quarter, and then you see that change over the rest of the year. So we believe we can grow organically here. And as Tim mentioned, it will be lumpy, but we have lots of opportunity.

Betsy Graseck - *Morgan Stanley - Analyst*

Right. Then I guess just the last question on this topic is competition. So clearly there is competition with other banks. There's also competition with the capital markets, right, because interest rates are so low. So just wondering how do you deal with that, in particular in the commercial real estate and the C&I space where your borrowers might be able to access longer-term funds [cheaper] than they have historically? Would they choose to be doing that as opposed to drawing down C&I lines or doing a (technical difficulty)?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, they might. No, it's a fair question. I think depending upon what is going on in the capital markets, you can see an ebb and flow back-and-forth. I think from our perspective -- look, even though we want to grow loans, the most important thing is to do the right thing for the customer.

And because of the fact that we have got a broader base of product and services today, including an Investment Banking capability, unlike maybe where we were a few years ago, we can help them do that. So we sit down with our customers and give them our best recommendations. If it is a commercial real estate customer, whether or not we can do it on balance sheet or whether we can do it in the CMBS market, so on and so forth.

So there is no question there is always going to be competition from the capital markets. It was a little bit less in the third quarter of last year, a little bit more in the fourth quarter, probably a little bit more steady-state this quarter. But you are going to see that ebb and flow.

Betsy Graseck - *Morgan Stanley - Analyst*

Thanks.

Operator

Brian Foran, Nomura.

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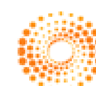

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Brian Foran - *Nomura Securities - Analyst*

Hi. I guess on the $1.7 billion re-class of home equities, I totally realize you guys have already reserved for it. But just in thinking about what the loss content on those loans might be, I guess Chase put out there a 55% cume loss rate on these kind of high-risk seconds. Is that a reasonable guess for the type of reserves you would already have against that bucket?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Our experience hasn't been 55%. I think that our view is that we needed to be consistent with this interagency guidance. We had taken into consideration the fact that these were junior lien loans behind sub-performing firsts for an extended period of time. This is the first time that we took that into our consideration in our loan-loss reserve.

So we think that we are adequately reserved. But we haven't seen a disproportionate incremental loss rate on this portfolio relative to others. But we take into consideration the loan-loss reserve and we have for a while.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

The biggest driver on losses here is jobs. If people have income and if they have work, that drives it more than anything else. But also there is no question that once they don't have a job, the severity is almost complete.

So in other words, you lose most of it. But we are not running at those kind of numbers.

Brian Foran - *Nomura Securities - Analyst*

Then I know you've touched on a lot of the different aspects of HARP, but just one follow-up would be on -- how does it affect the gain on sale outlook for the mortgage business over the remainder of the year?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, I think it's going to be just a function of volume. I think we -- if the HARP 2 is successful, it will continue to increase volume. The margins that we've had have been good; but I think generally they had been a little bit overstated in the market in terms of media reports and the like.

Again, HARP 2 loans are good. The program seems to be catching on. It's in its early stage. And the way that we price those loans is they're similar to any other refinance.

Brian Foran - *Nomura Securities - Analyst*

If I could sneak in one last one, I guess going back to John's question on the risk-weighted asset inflation. I agree with everything you said, but maybe the thing that is not obvious based on your business mix is the $346 billion higher risk-weighted assets under Basel III versus Basel I as of March 31.

How much it those, that risk-weighted asset difference between Basel III and Basel I, is something that would be permanent versus how much of it is from things that can be mitigated or reduced over time? Like sub-prime MBS that might be on the books or things like that.

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Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, let's step back for a minute. I guess I am disagreeing a little bit with the premise that somehow there is inflation in how we are calculating our risk-weighted assets under Basel III. The rules for Basel I and Basel III are just different.

You've got to take into consideration things like operating risk. You've got to take into consideration counterparty risk. And everybody is doing that in the industry. We are doing that.

So again, we feel comfortable with our calculation. We are not going to do anything inappropriate in terms of doing that calculation.

Having said that, we are going to make sure that it's appropriate; but again we are not overly concerned about our risk-weighted asset level just because of the fact that we got adequate capital in the Company.

Brian Foran - *Nomura Securities - Analyst*

Okay. Understood.

Operator

Erika Penala, Bank of America Merrill Lynch.

Erika Penala - *BofA Merrill Lynch - Analyst*

Good morning. Could you give us a sense of how you are treating any associated seconds if you are refinancing a first under the HARP program? Particularly if there is an underwater situation.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, we normally look at the exposure together or in tandem. But in terms of any additional specifics, we can get back to you. We will talk to our mortgage folks and follow up. But I don't think there is anything special going on.

Erika Penala - *BofA Merrill Lynch - Analyst*

I guess I am just wondering. I understand that the $1.7 billion increase in the home equity problem loans was part of a reclassification. But is the improvement generally in home equity problem loans for the industry going to be stagnant, as perhaps some of the underwater home equity loans are charged off, as the firsts are refinanced under HARP? Am I thinking about this the wrong way, or --?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

No, I think you're thinking -- here is how we think of it. Every time, anything we can do to help a customer reduce their first mortgage obligations, to a refinancing to lower rates or modifications of the first, obviously it helps the second. Because it's about the total expense and the debt to coverage around that.

So as part of how we normally work with customers, we look at -- with respect to their debt, and we work through the refinancing. So the reclassification has (technical difficulty) familiar with many of the borrowers, and we have relationships with them right now. We are in a number of the deals. So I would say it is consistent.

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Erika Penala - *BofA Merrill Lynch - Analyst*

Okay. Thank you for your time.

Operator

Ed Najarian, ISI Group.

Ed Najarian - *ISI Group - Analyst*

Good morning, guys. So a couple of questions. First one is a follow-up to John McDonald's question on the operating costs. I guess I am just trying to think about the trajectory of the decline in how you are describing it.

I get the idea of getting to the high end of the range by 4Q on higher revenue. But in the fourth quarter you were $12.5 billion on cost. You said we expect them to remain elevated in the first quarter but then decline significantly starting in the second quarter.

Now, we're up to $13 billion and you're looking for a $500 million to $700 million decline in the second quarter. That takes us down to $12.3 billion to $12.5 billion on your guidance.

I guess I am wondering, why is that second-quarter number not materially below the fourth-quarter number? Especially given that it won't include a Wachovia integration cost, whereas the fourth quarter included a fairly large one. Do you expect more litigation? Or what is it that I am missing on 2Q versus 4Q?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, Ed, I think that based on what we see in the second quarter, we are comfortable in providing the guidance that our expenses are going to be down between $500 million and $700 million. Could they be a little bit more than that? They could. Right?

But we are comfortable with that number right now. And again that number is based upon an expectation of revenues. We feel comfortable -- as we mentioned we enter this quarter with some nice tailwinds in terms of the mortgage pipeline as well as some acquisitions that we have mentioned.

So could the number be a little bit bigger? It could; but we are comfortable with that range.

Ed Najarian - *ISI Group - Analyst*

Okay. But given that you don't -- if we take out Wachovia integration expense from the fourth quarter, it would actually be up somewhat from the fourth quarter ex-integration costs. Is that outlook because of higher incentive comp? Or what is it that would be driving that core number up a little bit versus 4Q, as opposed to down ex the Wachovia integration in 4Q?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well again, Ed, you're jumping --

Ed Najarian - *ISI Group - Analyst*

I'm just trying to pinpoint where your thoughts are on how that is trending.

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Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, you are jumping to the conclusion that it will be up. We are saying that we feel comfortable with the $500 million to $700 million guidance. There is always going to be some puts and takes in our expenses as we move through the quarter.

But again, we believe that we are going into this quarter with nice revenue, right? As we have demonstrated this quarter -- think about it. Our revenue was up $1 billion from the fourth quarter.

Do you have a little bit more expense related to that? Of course you do. Our revenue was up $1.3 billion from the first quarter last year. Were there a little bit higher expenses? Of course there were.

So we're feeling good about this quarter, and we feel good about the $500 million to $700 million. Could it be a little bit higher in terms of the reduction? Sure, it could.

Ed Najarian - *ISI Group - Analyst*

Okay, all right. Thanks. Then just one more. When I look at the net interest margin and it expanding by 2 basis points, what seems to have been the surprise factor was the overall yield on your commercial loan portfolio going up by 6 basis points from 4.10 to 4.16 in the fourth quarter to the first quarter.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

That's right.

Ed Najarian - *ISI Group - Analyst*

Is there anything in there that is abnormal? Or is there any thoughts about what caused the yield on the commercial loan portfolio to go up a little bit linked-quarter versus down a little bit?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Now, I wouldn't say there is anything abnormal in that. I think we are starting to see the yield to settle down just a bit. Every quarter we have some level of volatility in terms of special items that are in the numbers. You saw some of that last year, too. But there is nothing abnormal in there.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Yes, and that is actually influenced a little bit by some of the workouts that we do on the commercial side, so that will bump around a little bit. But I think it's important as long as we are talking about the NIM to mention two things; and you know both of these, Ed.

First of all, we don't manage the Company around the NIM. And secondly, I still think it's going to be under pressure going forward.

Ed Najarian - *ISI Group - Analyst*

Okay. I didn't get a chance to look real closely at how the accretable yield came in. But were there some commercial loan sale gains that impacted -- on marked commercial loans that impacted that yield at all in the first quarter? Or not really?

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John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

It wasn't much. It wasn't much. But there is always a little bit here and there.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

That wasn't a driver in terms of the NIM. In fact, the accretion was actually down a little bit, from $552 million to $514 million in the first quarter.

Ed Najarian - *ISI Group - Analyst*

Okay. All right. Thank you very much, guys.

Operator

Paul Miller, FBR Capital Markets.

Paul Miller - *FBR Capital Markets - Analyst*

Yes, thank you very much. I know you're probably sick of talking about HARP, but as of April 1 -- I mean, have you guys disclosed how much of HARP-eligible loans are within your servicing portfolio?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

No.

Paul Miller - *FBR Capital Markets - Analyst*

Secondly, as of April 1, I believe that you can start to refi other people's servicing portfolios under HARP. I was just wondering, you did -- I think the jury is out if that's a smart move or not. Have you made any decision on that yet?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Well, Paul, how we think about that -- first of all, since a lot of HARP loans you get through a marketing, you need to know where people are. It is easier to do your own portfolio than someone else's.

That being said, we want to take on all comers. And this is where our cross-sell and the Community Bank gets very involved as they talk with customers and frankly other parts of the Company where we are able -- if someone has a mortgage that is not with us, that we can do. But I would say we will know more about that as time goes on. But I would bet the biggest part of the HARP 2s that we will do will be for our own portfolio.

Paul Miller - *FBR Capital Markets - Analyst*

Okay.

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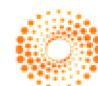

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Just in terms of knowing the information.

Paul Miller - *FBR Capital Markets - Analyst*

Okay, and then going back -- because I didn't quite understand the answer. I didn't get it correct, I think. On the HELOC portfolio, of which I believe it was like close to $1.6 billion that you moved over. (multiple speakers) Was there other -- $1.7 billion; sorry about that.

Was there other loans that were the first that defaulted that are not nonaccruals in the HELOC portfolio?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

No.

Paul Miller - *FBR Capital Markets - Analyst*

No? So this is the entire community of loans where the first has been defaulted?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Correct.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Correct.

Paul Miller - *FBR Capital Markets - Analyst*

Okay. Hey, guys. Thank you very much.

Operator

Matt O'Connor, Deutsche Bank.

Matt O'Connor - *Deutsche Bank - Analyst*

Hey, guys. Hopefully I didn't miss it; I know you commented on NIM being under pressure, but (inaudible) loans. When we combine those two and think about your both capacity and desire to buy some more securities, how does that all shake out for net interest income dollars from here?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, I think as John said, we continue to believe that the net interest margin is going to be under pressure. Having said that, I think that we have got the ability to grow loans organically. We believe that we can do that. The core loans were up again this quarter, a little bit less than in third and the fourth quarter; but we feel confident about our ability to grow our core loans.

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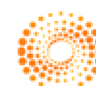

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One of the other things that I think is important to note is that diversification in terms of the loan growth this quarter was a little bit better than the third and the fourth quarter, because we saw auto loans and student loans growing, whereas in the third and the fourth quarter it was a little bit more of a focus on Wholesale Banking. As it relates to -- but the other avenue we have, obviously, to grow loans is through acquisition. We have continued to demonstrate that we are active there and we are paying appropriate prices and bringing new customers to the Company.

In terms of securities purchases, we are going to continue to manage the portfolios we have very prudently. We are not going too far out on to the curve.

Having said that, if we got incremental liquidity that's not needed for our customers in terms of loans, we are going to invest appropriately. You saw our securities increase about $7 billion, $8 billion this quarter, so we will continue to do that.

Then I think the other point to make is just in terms of the input costs. That is, we have been able to continue to grow deposits while reducing our deposit costs. So we feel good about the ability to grow net interest income.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay, great. Then separately, as we think about the provision expense, I was just looking at one of the slides. In the last few quarters the provision expense in dollars has been relatively stable. It seems like you still have quite a bit of excess loan loss reserves.

Most of the credit metrics continue to improve from here -- or up until here. How do we think about the pace of reserve releases going forward?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, it's a fair question. I think we believe that we will have incremental reserve release, whether that -- I'm not 100% sure what the pace is going to be. We don't really make those decisions until the end of the quarter.

But we do think, based upon the continued improvement in the portfolio, which we continue to see, that we will have additional reserve release. But it's going to be less than it was last year. The pace of improvement has slowed down a little bit.

I think the important thing is that we have gotten through the point at which the lines of the reduction in the loan loss reserve release and the improvement in charge-offs cross, so that what we are seeing is a real kind of down division provision expense and net charge-off levels.

Matt O'Connor - *Deutsche Bank - Analyst*

Then just lastly if I could sneak in a third one here, the tax rate calculated was around 35% this quarter. It's averaged probably 25% to 33% the last three years.

Anything different? Or just a little more conservative earlier in the year?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

No, it was up a bit this quarter. We think that the tax rate for 2012 is going to be higher than last year because we're making more money; but beyond that, I wouldn't read anything into it.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay, thank you.

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Operator

Mike Mayo, CLSA.

Mike Mayo - *CLSA - Analyst*

Good morning. Just to further clarify, so your expense guidance is $250 million higher; and, John, you said you're not going to be slavish to any one target. Can you guys commit to having positive operating leverage?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Yes, absolutely.

Mike Mayo - *CLSA - Analyst*

So you are going to miss it, but revenues will be a lot more high -- or least higher than that $250 million, no matter how we slice it?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

We're not saying that.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

No, we're not going to miss it. A year ago we gave guidance six quarters ahead, and we gave you a range of $10.75 billion to $11.250 billion. But we said then and we said now that was based upon a certain set of revenue assumptions. We're going to come in at the high end of the range.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Because revenues are at the high end.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Because revenues are higher, not because we are not executing on our expense reductions.

Mike Mayo - *CLSA - Analyst*

Okay. Then separately, John especially for you, if I asked you 15 years ago what bank this quarter might have some of the best year-over-year growth in investment banking -- as you guys said it's up 20%; record wholesale; and the biggest absolute growth in syndicated loan volume, would you ever have guessed it would be your Company as opposed to JPMorgan, Bank of America, Citi, Goldman, Morgan Stanley or some of these firms that are no longer around?

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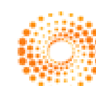

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So my question really is -- is this mission creep? Is this opportunism? What has changed from going back?

I know you have evolved with your acquisitions, and I am sure we will talk more about this at Investor Day. But it seems as though you are getting farther away from what made at least legacy companies strong; and you are doing more activities further away from your headquarters. So how should we think about that?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Well, when I think of 15 years ago, I had a mustache and dark hair, so you are dating me now. But let's think about this, Mike.

The Company today clearly has evolved, but I think it is a more customer-relevant; safer; our risk profile is reduced from 15 years ago. And if you think about the business, look at the balance of the business today.

But before I get to that, what's stayed consistent is we continue to be a relationship business. We are in the relationship, the long-term relationship with our customers. And today we have more products to offer these customers to help them succeed financially.

We are more balanced. If you look at our income statement, this quarter half of the revenue comes from fees for services, half from the margin. Half comes basically from wholesale and half from consumer.

We now have diversity of geography. So I think if you look at that 15-year period you should even be happier today then -- and it is safer, more diversified, more customer-focused, more value. And we will talk about this more at Investor Day, but I think the evolution over that time reinforced what we were trying to do 15 years ago, not moving away from it.

Mike Mayo - *CLSA - Analyst*

Then specifically as it relates to syndicated loans, again I am surprised if I look at first quarter of this year versus first quarter of last year. The biggest dollar amount increase in acting as agent for syndicated loans is Wells Fargo. I'm just --

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John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

You know what, Mike? That is a great thing, right? Why are people coming to -- why our customers coming to Wells Fargo? Because they believe in our model. They believe in the Company.

They like the people they work with. They know that we have got a strong balance sheet. They know that we're going to be able to deliver for us. That is a great thing. It diversifies the business and it reinforces the model.

Everything around here starts with the customer. Why wouldn't we want to help our customers? Why wouldn't we want -- if we deal with a large Fortune 500 company, and we are doing loan business with them, and they want to issue debt to buy a subsidiary or whatever, why wouldn't you want to help them do that?

We happen to have 15,000 terrific retail brokerage people out there, advisers who can help with that and sell this. And we have great people on -- to help them price the debt or the equity. This is what we ought to be doing.

Mike Mayo - *CLSA - Analyst*

Then last follow-up --

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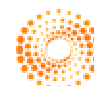

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John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Go ahead.

Mike Mayo - *CLSA - Analyst*

No, no. I will let you finish too, but we can finish at the Investor Day. But is some of this opportunistic, though? Because the European Bank's market share in this area has gone from, what, 37% down to 21% over the past year.

So not only -- I guess I am hearing you say your clients want this more. But is this some Wells Fargo opportunism?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Well, of course. There are -- some of the foreign banks are retreating to their home countries. The industry has changed in a lot of these areas.

You know, we celebrated our 160th birthday a few weeks ago. We have always evolved. We always have changed in product offerings and channels. But what's stayed true around here and will continue to stay is that it is all about long-term relationships with our customers, helping them succeed.

So when I look at percentage changes from year-over-year or whatever, I don't -- first of all, percentages always have a enumerator and denominator. I don't get too excited about that.

What I get excited about is if we keep customers at the center of what we do, great things happen. It always does.

Mike Mayo - *CLSA - Analyst*

All right, thank you.

Operator

Nancy Bush, NAB Research, LLC.

Nancy Bush - *NAB Research, LLC - Analyst*

Good morning, guys.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Nancy, have you gone to your ATM lately?

Nancy Bush - *NAB Research, LLC - Analyst*

I have. Thank you very much for my special message. Now the people in the bank -- now I'm standing in front of the ATM laughing and the people in the bank think I'm crazy.

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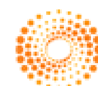

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So anyway, two questions for you here. Something we haven't heard a lot about lately is Wells Fargo Financial. Could you start to talk about what the results have been since you have moved or tried to move the Wells Fargo Financial people into the branch?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Yes, those folks, most of those folks on the production side -- many of them went into the banks and they become personal bankers. They are helping us serve customers, make loans. So yes, that has been very successful.

Nancy Bush - *NAB Research, LLC - Analyst*

Have you been able to track how many -- how much business you might have lost for people who just don't want to go into a bank branch to get their loan or whatever?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

We have really not. But what has happened is we actually have more distribution now, because we got rid of 700 or 800 stores, but we picked up 3,000 with the acquisition of Wachovia. So I don't -- I have not heard, as I'm out there on the street I have not ever heard from anyone that I prefer not going to a bank, or I prefer going to a finance office.

What has changed mostly in that business, Nancy, is that much of what we did in Financial were loan accommodations, where we would take three or four different loans and be a debt consolidation on homes. Of course what has happened to home values, that business really changed a lot.

But the people we brought over were primarily lenders. They knew that part of the business well, so that helped enculturate even more in our banking stores this idea that we want to also be a great place to borrow money, if your credit qualifies.

Nancy Bush - *NAB Research, LLC - Analyst*

My second question goes back to this point, and it incorporates HARP and HAMP and all the other issues that we've had around mortgage banking. But it's an issue or it's a question that relates more to moral hazard going forward.

You know, we have had all these changes. People have found that they can have their principal reduced; they can have their rates reduced; etc. etc. So how does that impact your underwriting of a mortgage going forward?

Do you have to put a big orange sticker on it saying -- we really mean this; this is really what the thing is going to be? Or how do you think about that? How do you see yourself going forward?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Well, it's a great question. So a couple things first of all to think about. Of the 50 million mortgages in America, about 10 million or 11 million are underwater. And of those 11 million, 90% or so are current. So generally Americans by a vast majority want to pay their bills if they have the income to do it.

Secondly, you build your best portfolios, whether it is for your own account or whether you sell it off and keep the servicing, you build your best portfolios after a downturn, not going into a downturn. When the bubble is expanding you usually have your worst portfolio builds.

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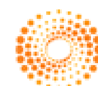

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And the third thing is on the big yellow sticker, I don't know that -- or the orange sticker -- today, in fact since really 2008, the mortgage business has retrenched and it is more like it was done prior to 2002 or '03, where there is full documentation, income verification, a proper amount down depending on which program it is.

So, I'm -- and I think nothing would fix all of this more than a little appreciation in housing and getting to the bottom, which I think we are very close to that point where we are going to see an inflection point here. So I don't know if I answered your question, but that is how we think about it.

Nancy Bush - *NAB Research, LLC - Analyst*

But you think you are just getting a better customer who will treat their mortgage document a bit more carefully or take it more seriously going forward than did some of the people coming into this?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

You know, Nancy, I think that's a good point. I think everybody involved in a mortgage needs to have skin in the game such that mortgages are good. I mean that is the originator, that is the borrower, that is the realtor that puts the borrower and whatever together if it is a purchase. It is people who package and the rating agencies and the servicing.

And the mortgages aren't complete until they pay off and it is well done. So it's the whole process. I think everybody is showing more care and diligence today, and that is a good thing.

Nancy Bush - *NAB Research, LLC - Analyst*

Okay, thank you.

Operator

Scott Siefers, Sandler O'Neill.

Scott Siefers - *Sandler O'Neill & Partners - Analyst*

Morning, guys. I just had a quick question on the mechanics of the new regulatory guidance and that $1.7 billion that you moved over. So since it is now in nonaccrual, obviously you don't accrue the interest. But the vast asset majority is still paying, so the cash is coming in.

When you receive that cash, does that go into NII now? Or does it go directly to pay down principal balances on the related loans? How does that work?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Like all nonperforming assets -- or nonperforming loans, this isn't different; it pays down the principal.

Scott Siefers - *Sandler O'Neill & Partners - Analyst*

Okay. So there is some -- in your case it is an extraordinarily small amount, but some go-forward ramification I guess to the earnings stream then?

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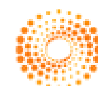

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Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

It's not material.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Yes, it's just --

Scott Siefers - *Sandler O'Neill & Partners - Analyst*

Yes, okay. Perfect. That was all I needed to know. Thank you.

Operator

Freddie Cannon, KBW.

Brian Kleinhanzl - *Keefe, Bruyette & Woods - Analyst*

Hi, this is actually Brian Kleinhanzl on for Fred. So I just had a quick question on the rep and warranty. It looks like the repurchase demands are coming down, have been coming down over the last couple quarters; but the reserve keeps building from here.

Is there a target they are trying to get to? Or when can we finally see that the reserve is starting to come down for the rep and warranty?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, a fair question. Total demands outstanding, both number and balances, were down in the first quarter and were down roughly 25% year-over-year. The new agency demands for the more difficult vintages, the '06 to '08 vintages, declined a bit from the fourth quarter.

But the additions that we put into the reserves were more or less in line with last quarter. We continue to add to the reserve due to the elevated demands from Fannie and because of the projected higher mortgage insurance rescissions. Freddie has been in line, so we are hopeful it is going to come down at some point; but we just haven't seen it come down enough yet so that we would want to reduce the reserve.

Brian Kleinhanzl - *Keefe, Bruyette & Woods - Analyst*

Okay, great. Then on a separate topic, you used to give a disclosure about the excess liquidity that you have on the balance sheet. I haven't seen that the last couple quarters.

What is it that you think the excess liquidity is right now on the balance sheet? And given that the Basel committee just came out with -- saying that there is a large shortfall under their Basel III standards, what is your idea of what that excess liquidity is for you?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, I don't recall -- we will go back. I don't recall us giving any sort of guidance as to what our excess liquidity is. I can tell you that we've got a lot of liquidity right now, which is terrific. It has allowed us to grow the loan portfolio year-over-year and grow the securities portfolio in a smart way.

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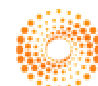

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We are still working through and the regulators are still working through what the new liquidity guidance is going to be, related to Basel III. There's a lot of discussion going on about that. But when you look at our balance sheet, particularly how we are continuing to grow low-cost deposits, we don't have a liquidity issue at all.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

See, I think that is the key, Brian. When you look at this Company, our liquidity is such solid -- I mean, can you imagine $900 billion plus of deposits at 20 basis points and then virtually all of it's core? A big chunk of it is consumer. So this is just so, so valuable and so undervalued today, given where interest rates are.

Brian Kleinhanzl - *Keefe, Bruyette & Woods - Analyst*

Yes, and just a quick question on those deposit costs. I mean we saw them come down again this quarter, basically on that core funding. Is there still room for those to come down in the following quarters? They are already kind of at an industry low, so do you guys think there is a lot more room?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

You know what? Every time we get to a lower number, we talk to our folks and we ask them to continue to not compete on price; to compete on value and relationship. And I think that is one of the primary reasons we are able to continue to reduce costs.

Whether or not we're going to be able to continue to do that in the future, I don't know for sure.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

We're getting pretty close here, but it's down 10 basis points in a year. I don't think if you sat here a year ago and said, could you bring them down 10? People would have said, I don't think you can.

So we're always looking to find that right area. But the reason they are coming down is more about the mix as opposed to -- we have to compete, as we do. But, you know, when you have the number of checking or near checking that we have, that is just magical.

Brian Kleinhanzl - *Keefe, Bruyette & Woods - Analyst*

Okay, great. Thanks for taking my questions.

Operator

Andrew Marquardt, Evercore Partners.

Andrew Marquardt - *Evercore Partners - Analyst*

Just a follow-up on that last question, in terms of the margin guidance. You had talked about how, despite the 2 basis points better this quarter, that we should expect some pressure going forward.

Just hoping to get some color in terms of magnitude. Is it in the low single-digit range? And it also sounds like despite that you still feel confident in holding the NII up with loan growth and earning asset growth.

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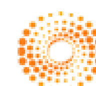

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Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, Andrew, it's a fair question because there has been a lot of volatility in the NIM, which is candidly why we don't manage to it. I don't know what the NIM is going to be this quarter and I don't know what it's going to be next quarter.

What we do know is just the math is that there is pressure on it for sure. We are hopeful that we can continue to relieve that pressure as best we can through a reduction in our deposit costs.

But in terms of specifics, I am not going to provide any guidance because I can't.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

But Andrew, you are right in the fact that -- forget the margin, look at net interest income. That is really what drives us, because that is the result of the work we do every day of getting new customers and selling more things and so forth, getting deposits and selling loans.

I wake up and think about that more than I do about the NIM. And there we think we have good opportunities to continue to produce the kind of things that drive net interest income.

Andrew Marquardt - *Evercore Partners - Analyst*

Got it. So is it fair to assume then the confidence in terms of a higher NIM really won't come until the macro backdrop really improves in terms of a higher rate environment? Is that fair, or maybe the runoff portfolio slows?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

I think it -- I wouldn't say it is confidence, I think it is more probability. I think it is less likely that the NIM is going to grow. Not impossible, because we have been able to grow it a little bit over a few basis points in the last couple of quarters since the decline in the third quarter last year. It is just a little bit less likely.

Andrew Marquardt - *Evercore Partners - Analyst*

Got it. Then lastly, just on the -- going back to expenses in terms of the slight change in terms of the guidance for year-end, at the upper end now. You had mentioned that that is driven by higher confidence in revenue. We're feeling better about revenue than you had before.

Can you help us understand exactly what part -- where exactly do you feel better about it? Is it really in mortgage banking or trading, or what is it that makes you feel better?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Across the board.

Andrew Marquardt - *Evercore Partners - Analyst*

Okay, so no one particular area feeling better in terms of mortgage having greater strength, or trading coming in better?

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John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

No.

Andrew Marquardt - *Evercore Partners - Analyst*

Great. Thank you.

Operator

Chris Mutascio, Stifel Nicolaus.

Chris Mutascio - *Stifel Nicolaus - Analyst*

Mr. Irrelevant again. Hey, John, how are you? Tim? I think this is the second quarter I'm dead last. Hey, I'll take that; thank you for the time.

Three quick questions. Tim, on the -- the margin guidance in terms of percent or dollar amounts, does that take into consideration perhaps more aggressive TruP redemptions than just the $875 million announced today, or redeeming today?

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

No, we are getting through the really the trail end of the TruPS redemptions that we are going to be doing. Most of the activity occurred last year, so that's -- we will continue to redeem TruPS in an appropriate way; but it's not going to be as big a driver as it was last year.

Chris Mutascio - *Stifel Nicolaus - Analyst*

Okay. The second thing is, gain on sale margins this quarter versus last quarter, do you have those handy on the mortgage side?

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

For the mortgage?

Chris Mutascio - *Stifel Nicolaus - Analyst*

Yes.

Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

This quarter it was I think 2.36%, and that is up from 1.9% in the fourth quarter.

Chris Mutascio - *Stifel Nicolaus - Analyst*

Okay. Then finally, with the robo-signing settlements, do you have discretion on who you modify? In other words, can you modify the firsts that are delinquent ahead of the -- ahead of your own home equity loans?

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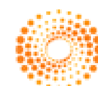

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Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

We certainly have discretion in terms of what you modify. There is not a -- there aren't specific requirements for specific borrowers. We made -- and there is a lot of detail in our 10-K in terms of the specifics on the settlement. Rather than go through that in detail right now, I would just ask you to take a peek at that. We provide a lot of detail about how we see the settlement and how it would affect us.

Chris Mutascio - *Stifel Nicolaus - Analyst*

All right. Thank you so much.

John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

Thank you, everybody, and thanks for joining our call. We appreciate your interest and also of the ones who asked the questions. Thank you much and we will see you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you all for participating, and you may now disconnect.

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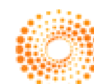

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