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EDITED TRANSCRIPT

WFC - Q3 2012 Wells Fargo Earnings Conference Call

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OVERVIEW:

WFC reported 3Q12 earnings of $4.9b and EPS of $0.88.

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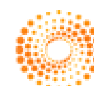

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PRESENTATION

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 third-quarter earnings conference call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks there 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 - IR*

Thank you, Regina. 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 third-quarter results and answer your questions.

Before we get started, I would like to remind you that our third-quarter earnings release and quarterly supplement are available on our website at WellsFargo.com. 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.

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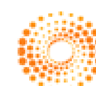

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Factors that may cause actual results to differ materially from expectations are detailed in our SEC filings, including the Form 8-K filed today containing our earnings release and quarterly supplement. Information about any non-GAAP financial measures 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.

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. Good morning, everyone, and thanks for joining us today. Our results in the third quarter demonstrated the underlying strength of our diversified business model and our ability to earn more of our customers' business driving outstanding performance throughout our franchise.

Let me quickly review some of the highlights of the quarter. We achieved record net income, up 22% from a year ago, and EPS was also up 22%. Revenue grew 8% and pre-tax pre-provision profit increased 14% from a year ago.

Our core loan portfolio grew 6% and core deposits were also up 6% from a year ago. We had positive operating leverage and our efficiency ratio improved by 240 basis points from a year ago.

We had continued strong underlying credit performance. Our profitability ratios reflected the strong results with our return on assets growing to 1.45%, up 19 basis points from a year ago, the highest it has been in five years. Our return on equity increased to 13.38%, up 152 basis points from a year ago.

Our estimated Tier 1 common equity ratio under Basel III reached 8.02% as we continue to have strong capital growth while remaining focused on returning more capital to our shareholders.

This strong performance during a period of slow and uneven economic growth was driven by momentum across Wells Fargo's diversified businesses. We have a broad set of products that enables us to meet all of our customers' financial needs, which is reflected by our record retail banking cross-sell this quarter of 6.04 products per household.

In the current low rate environment, our mortgage business continued to benefit from strong refi and purchase volume, and credit quality reached and reflected an improving housing market. Our credit card business is successfully generating new account growth, up 46% from a year ago and we are focused on increasing customer card usage, which is generating strong balance and fee growth. We have grown managed accounts assets in our retail brokerage business over 25% in the past 12 months, driven by strong net flows and market performance.

Our Wholesale Banking business continues to meet the financial needs of our commercial customers generating nine consecutive quarters of loan growth from our middle-market customers. We are also meeting the lending needs of our small business customers with $11.4 billion of new loan commitments so far this year, up approximately 30% from a year ago.

These are just a few examples of the momentum we have throughout our businesses as we remain focused on better serving our customers while we continue to be diligent in managing our costs and risks. Our ability to meet a broadly diversified set of customer needs throughout a variety of economic cycles is a clear Wells Fargo advantage and contributed to another strong quarter for our company. Tim Sloan, our Chief Financial Officer, will now provide more details on our financial results. Tim?

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

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

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As John highlighted, we had a very strong quarter with record earnings of $4.9 billion, up 7% from the second quarter. Earnings per share were a record $0.88, up 7% from last quarter, our 11th consecutive quarter of EPS growth and the sixth consecutive quarter of record EPS.

Our ability to consistently generate earnings growth reflects the benefit of our diversified business model. We are balanced between fee and spread income and our sources of fee generation are also very diversified. As John highlighted, we had many businesses serving our commercial and consumer customers that had strong growth this quarter, and I will provide more examples throughout my comments today.

I am going to highlight some of the key drivers of our results this quarter starting on page four and then I will discuss them in more detail later in my remarks.

We had strong balance sheet growth in the quarter. We grew both our total and core loan portfolios with growth in commercial and consumer portfolios. We once again had strong deposit growth with balances up $23 billion.

Turning to credit, we continued to have strong underlying credit performance this quarter. However, our reported results were affected by regulatory guidance issued to the industry by the OCC.

The guidance covers consumer loans that are current or less than 60 days delinquent where the borrower has declared bankruptcy. The implementation of this guidance resulted in a $1.4 billion reclassification of performing consumer loans to non-accrual and $567 million in net charge-offs, which was fully covered by our loan-loss reserves. Absent this change, credit performance continued to improve, which I will also highlight later on the call.

Turning to the income statement, net interest income was down as our net interest margin declined as expected from the second quarter. We had strong noninterest income growth across a number of our businesses this quarter and we remained focused on reducing expenses and we generated positive operating leverage. Let me now cover our business drivers in more detail.

As shown on page six, period-end loans were up $7.4 billion from the second quarter with growth across a number of commercial and consumer portfolios. The liquidating portfolio declined by $4.5 billion and our core loan portfolio grew by $11.9 billion. We have now grown our core portfolio for eight consecutive quarters.

Commercial loans declined $1.5 billion as growth in C&I and real estate construction loans was offset by declines in our real estate mortgage loans, leases, and foreign portfolios. Consumer loans increased by $8.9 billion with growth in first mortgage, auto, credit card, and private student lending. The growth in our first mortgage portfolio was due to our decision to retain $9.8 billion of new conforming fixed-rate production with most of this coming later in the quarter.

While retaining these mortgage loans on our balance sheet reduced mortgage revenue this quarter, we expect to generate spread income in future quarters for mortgage loans with higher yields than mortgage-backed securities we could have purchased in the market. We are in a unique position to have a large enough mortgage business and strong capital to be able to make these choices that should benefit long-term results. We currently expect to retain additional conforming mortgages in the fourth quarter.

Average loan balances increased $8.5 billion from the second quarter, benefiting from strong consumer loan growth and the late second-quarter close of the WestLB portfolio.

Deposit growth remains strong this quarter with average deposits up $22.5 billion from the second quarter and up $63.9 billion, or 7%, from a year ago. Average core checking and savings deposits were up 9% from a year ago and were 94% of average core deposits.

We continue to benefit from lower deposit loss costs with average deposit costs of 18 basis points in the third quarter, down 1 basis point from the second quarter and down 7 basis points from a year ago. We have successfully grown deposits while reducing our deposit costs for eight consecutive quarters.

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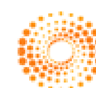

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Tax equivalent net interest income declined $393 million from the second quarter. Average earning assets grew $26.3 billion linked quarter with growth in short-term investments and mortgages held for sale.

As we expected, the NIM was under pressure this quarter. The 25 basis point decline in the net interest margin was driven by three primary factors.

First, variable income declined from strong second-quarter levels, which accounted for 10 basis points of the linked-quarter decline in the net interest margin. Second, approximately 8 basis points of the margin pressure was driven by continued balance sheet repricing as higher-yielding earning assets ran off and we were cautious in our reinvestment activity, focusing on shorter duration securities. Specifically, 6 basis points of the decline was from our available-for-sale portfolio and 2 basis points of the decline was from the loan portfolio.

Third, the remaining 7 basis points was driven by strong deposit growth we had in the quarter and invested in short-term investments in Fed funds sold. As we have highlighted for the past year or so, we expect continued pressure on the net interest margin given this low rate environment. However, we don't believe the net interest margin decline we had this quarter is representative of what we will see in the future.

Noninterest income increased $299 million from the second quarter, up 3%. Growth was broad based and included a 6% increase in deposit service charges, which was driven by product and pricing changes that we have now rolled out throughout our geographies. Trust and investment fees grew $56 million, or 2%, from the second quarter, reflecting strong asset-based fees in retail brokerage and asset management as well as higher retail brokerage transaction volume.

Credit card fees increased 6% from the second quarter driven by new account growth and higher volumes, including a 5% increase in credit card transactions. Trading gains were up $266 million with $153 million of higher deferred compensation and plan investment income, which was offset in employee benefit expense and stronger customer accommodation trading results.

Mortgage banking revenue declined $86 million from the second quarter driven by lower servicing income. The decline in servicing income was primarily due to a $350 million reduction in our MSR valuation for updating servicing and foreclosure costs. The ratio of MSRs to related loans serviced for others was at a historical low of 63 basis points.

Mortgage gain on sale revenue was up $396 million from the second quarter, despite approximately $200 million in foregone revenue from retaining conforming mortgage loans which I mentioned earlier. Third-quarter results included a $462 million provision for mortgage repurchase losses, which was $207 million lower than the second quarter.

Mortgage originations were $139 billion in the third quarter, up $8 billion from the second quarter and up $50 billion from a year ago. 14% of our origination volume this quarter was from HARP. The unclosed mortgage pipeline at quarter end was $97 billion, down from last quarter but still very strong, and volume during the first few weeks of October has accelerated as rates reached new lows.

Turning to expenses, we continue to make progress in reducing costs. Noninterest expenses were down $285 million from the second quarter. This decline includes lower personnel expenses from lower severance costs.

Operating losses were down $243 million on lower litigation accruals. Our litigation reserves consider all litigation matters we are aware of including the recently announced FHA lawsuit.

Insurance expenses declined $132 million due to seasonally lower insurance commissions. Our efficiency ratio continued to improve down to 57.1%, the lowest level in 10 quarters and within our target range of 55% to 59%. We expect to be within this range in the fourth quarter.

While we are pleased with the progress we have made, we remain focused on managing expenses even as we continue to benefit from strong revenue opportunities throughout our businesses.

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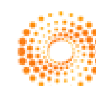

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Turning to our segment results starting on page 11, Community Banking earned $2.7 billion in the third quarter, up 8% from the second quarter. Retail Banking achieved a record cross-sell of 6.0 products per household, up from 5.9 a year ago. Cross-sell in the West grew to 6.4 and reached 5.56 in the East.

We continued to have strong partner referrals including such products as insurance, mortgage, and student lending, which were up more than 30% from a year ago. To support future growth, we consistently have invested throughout our franchise. For example, we increased platform banker FTEs in the East by more than 500, or 5%, from the second quarter.

Wholesale Banking earned record net income of $2 billion in the third quarter, up 6% from the second quarter. The results this quarter reflect strong fee income, solid loan growth, lower expenses, and improved credit quality. Credit losses in Wholesale Banking were just 8 basis points this quarter, reflecting higher recoveries and improved performance.

We had strong results across a number of our wholesale businesses. Let me give you a few examples.

Within our CMBS capital markets business we increased our market share from 8% of the second quarter to 15% in the third quarter as we securitized more of our own loans and also better met the securitization needs of our customers. Our asset management business grew assets under management by 3% from the second quarter and Wholesale Banking's cross-sell increased to 6.7, up from 6.5 at year-end 2011.

Wealth, Brokerage, and Retirement earned $338 million, down 1% from the second quarter, reflecting lower net interest income partially offset by higher brokerage transaction and asset-based revenue and lower net charge-offs. WBR client assets were up 4% from the second quarter, including strong growth in average core deposits, up 2%, and retail brokerage managed asset accounts up 7% driven by strong net flows and market performance.

Our continued focus on meeting our customers' financial needs is reflected in achieving a record cross-sell ratio of 10.27 products for WBR household driven by growth in retail banking products.

Turning to credit quality, as I highlighted at the beginning of my remarks, our reported credit metrics were impacted by the implementation of the OCC industry guidance related to bankruptcies. Page 14 highlights that our underlying credit trends, adjusted for this impact, continued to improve. Let me review our trends adjusted for this impact.

Net charge-offs declined $409 million from the second quarter and were 92 basis points of average loans. Provision expense was $1.6 billion in the third quarter, down $209 million from the second quarter reflecting better credit performance. Absent significant deterioration in the economy, we continue to expect future reserve releases.

Another sign of improving underlying credit trends was a $4.3 billion addition to the accretable yield balance primarily from our Pick-a-Pay portfolio. $3.6 billion was due to an increase in expected cash flows that did not affect the non-accretable difference and $687 million of the increase was a reclassification from non-accretable difference to accretable yield. These increases reflect an improved housing market forecast and credit outlook and will be recognized through net interest income over the expected life of these loans, which increased to approximately 13 years for our Pick-a-Pay portfolio.

Nonperforming assets were down $1.1 billion from the second quarter and were 3.04% of total loans. Loans 90 days or more past due increased [to] $132 million from the second quarter, reflecting normal seasonality in consumer loans, but were down $437 million from a year ago. Early-stage consumer loan delinquency balances and rates also increased from the second quarter due to seasonality, but were significantly better than a year ago.

Page 17 is just a reminder of the quality of our mortgage servicing portfolio with over 70% of the portfolios being with the agencies. The quality of our portfolio is demonstrated by the low delinquency and foreclosure rate on our servicing portfolio, which was over 400 basis points lower than the industry average, excluding Wells Fargo, based on the most recently publicly available data. Our total delinquency and foreclosure rate was 7.32% in the third quarter, down from 7.63% a year ago and a peak of 8.96% in the fourth quarter of 2009.

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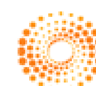

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We added $462 million to our repurchase reserve this quarter, down $207 million from the second quarter. Our repurchase reserve considers both outstanding reserves and also our future expectations for demands. Our repurchase reserve balance increased $269 million from the last quarter, reflecting $156 million of lower losses.

New demands from GSEs were actually down in the third quarter. However, our outstanding repurchase demands were up from the second quarter. This increase reflected higher non-agency demands, primarily due to new demands that have been previously reserved for. Agency outstanding demands were also up linked quarter, which reflected the demands from increased file requests we highlighted last quarter, as well as the times it is taking to work through those demands with the agencies.

As shown on page 19, our Tier 1 common equity ratio was 10.06%, down 2 basis points from the second quarter. Our third quarter ratio reflects refinement to the risk weighting of certain unused lending commitments that provide for the ability to issue standby letters of credit which reduced the ratio by 32 basis points. Importantly, this update did not affect our estimated Tier 1 common equity ratio under Basel III capital proposals, which grew to 8.02% in the third quarter. We continue to have a very strong capital position.

We purchased 16.5 million shares in the third quarter and entered into a forward repurchase transaction for an estimated 9 million shares that is expected to settle in the fourth quarter.

As we have highlighted throughout the call today, we have demonstrated momentum across our franchise as reflected in growth across a diverse group of consumer and commercial businesses. We have many examples listed on page 20. The main point is that across cycles different businesses drive our growth, which has been the reason for our consistent performance.

In summary, our balanced business model produced strong results again this quarter. We once again achieved record earnings and EPS. We grew pre-tax pre-provision profit, achieved positive operating leverage with reduced expenses, and had strong underlying credit performance. Our ROA increased to 1.45%, the highest in five years, and within our target range of 1.3% to 1.6%. Our ROE grew to 13.38%, also within our target range of 12% to 15%.

Our ability to achieve this growth in a low rate environment that is putting pressure on our net interest margin and in a quarter when mortgage revenue actually declined slightly clearly demonstrates the underlying momentum we have across our franchise. I will now open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Erika Penala, Bank of America Merrill Lynch.

Erika Penala - *BofA Merrill Lynch - Analyst*

Good morning. My first question was on the margin. Is there a seasonality in terms of deposit flows? Because you have $92 billion average cash this quarter and it was $98 billion last quarter. Sorry, last year same quarter.

I am just wondering -- and we had sort of a similar step down and more stability in other quarters. I am just wondering if there is a seasonality in deposit flows that we hadn't been taking into account.

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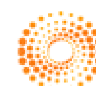

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Tim Sloan - *Wells Fargo & Company - Senior EVP & CFO*

Erika, that is a good question. I think throughout the year you can see some seasonality in our deposit flows. I wouldn't necessarily conclude that every third quarter we are going to have deposit growth like we had in the third quarter of last year and this year, but there is no question that part of the -- and a big reason for the net interest margin decline was because of the strong deposit flows. Particularly what we saw in September.

Erika Penala - *BofA Merrill Lynch - Analyst*

And it is clear that the momentum in core loan growth should absorb some of that excess cash on a go-forward basis. But could you give us a sense of how you plan to deploy and how much of the excess cash that you plan to deploy on a go-forward basis? Your reinvestment strategy that is not soaked up by core loan growth.

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

Well, the first call on any of our liquidity is for our customers and it is really going to be focused on core loan growth. As you saw this quarter, we decided to hold $9.8 billion of our conforming first mortgage portfolio, primarily because we viewed it as a very good investment opportunity for us given the risk reward of holding those mortgages, which were very high quality, versus buying a similar duration MBS at a big premium.

We were very cautious this quarter in terms of how we thought about our investment alternatives. And we are doing that because we are thinking about the investment portfolio for the long term.

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

And, Erika, I think Tim is absolutely right on that. We have to be very careful at this point in time not to just go out there and stretch for yield and take on a lot of interest rate risk. But the first call is always for our customers.

Erika Penala - *BofA Merrill Lynch - Analyst*

Okay. And just one last question on the margin and I will step off. On slide 15 you mentioned that there was a $4.3 billion increase in the accretable yield. I guess the way I am thinking about this is as the housing market in the US recovers you can continue to reclassify more of the non-accretable into accretable. And so that is clearly going to be margin support on a go-forward basis.

The negative impact that you mentioned on the margin this quarter, did that have to do with lower cash resolution from the Wachovia legacy book than last quarter? Am I thinking about those components the right way?

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

No, that is correct. The 10 basis points that we called out in the supplement was primarily because of lower resolutions, and as we mentioned in the second quarter, we had higher resolutions. Those are going to be volatile on a quarter-to-quarter basis.

But you're absolutely correct when you think about the impact on the non-accretable yield to accretable yield and then the expectation of cash flows from that portfolio, that as the housing market continues to improve that we will get benefit there.

Erika Penala - *BofA Merrill Lynch - Analyst*

Got it. Thank you for taking my questions.

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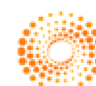

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Operator

Moshe Orenbuch, Credit Suisse.

Moshe Orenbuch - *Credit Suisse - Analyst*

Tim, could you perhaps maybe just drill down a little more into what you are seeing from the agencies in terms of the putbacks? I mean you talked about it a little bit. Can you kind of just -- I mean some of your competitors have already kind of had their reserves to the point where they are beginning to draw them down. Could you talk about that a little bit?

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

Sure. As we mentioned, we added $462 million to the repurchase reserve this quarter, which was down from the second quarter which was $669 million. And there is a little bit of noise in the puts and takes there because the new agency demand levels were actually down. So these are new agency demands were down this quarter, which is a good sign.

I don't necessarily think that it means we should declare victory and they are always going to be down, but that is a good sign that we haven't seen for a while.

The outstanding demands from the GSEs were actually up a little bit, and this reflects a couple of things. One, remember our expectations from last quarter as well as the fact that it has taken a little bit longer to work through file requests. But the non-agency demands were actually up this quarter.

So there is a lot going on there and we continue to have a lot of discussion with the agencies. But there is nothing that we have seen yet that would indicate that the decline that we saw this quarter is certainly a trend. I hope it is, but I can't guarantee you that that is going to be the case.

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

There are a couple of big -- step back a little bit, a couple of issues that are encouraging. First of all, real estate is getting better. We saw it in housing a year ago and every quarter we have more confidence that this -- we are not back to where we need to be and it is not as robust as we would all want it to be, but that is good on the repurchase side as values go up.

And, secondly, we continue to get further and further away or it is further in the rearview mirror the 2006 through 2008 portfolios. Every quarter we go we are getting through that. So those are things that are encouraging.

Moshe Orenbuch - *Credit Suisse - Analyst*

Great. Just on the mortgage banking front, a couple of just interesting trends. It looks like you took the pedal off on the correspondent business a touch and at the same time took the valuation of your MSR down, whereas JPMorgan had taken it up a little bit. Could you just talk a little bit about how we should think about the interplay of both origination volumes into the fourth quarter in 2013 and maybe perhaps the valuation of the MSR?

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

Sure. I will start with origination volume. We ended the quarter with a pipeline that was a little bit less than the second quarter, but at almost $100 billion it is still very strong. As we mentioned, volume has been strong so far this quarter being the fourth quarter, so we expect to have a pretty strong mortgage quarter in the fourth quarter.

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How long that lasts don't know for sure, but it feels like it is going to last at least a few quarters and obviously we hope it does.

In terms of the MSR valuation, the change that we made this quarter was just to continue to take into consideration the higher servicing and the foreclosure costs that we are seeing and to include that in the valuation of our MSR. And that yielded a $350 million write-down.

Moshe Orenbuch - *Credit Suisse - Analyst*

Great, thank you.

Operator

Joe Morford, RBC Capital Markets.

Joe Morford - *RBC Capital Markets - Analyst*

Thanks, good morning. Just first following up on the mortgage; can you just also comment about gain on sale margin trends in the quarter? Were they materially higher at all at year-end, I mean quarter-end?

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

No, they were at 2.21% which was about what it was in the second quarter at 2.2%.

Joe Morford - *RBC Capital Markets - Analyst*

Okay. And beyond that, any thoughts on the potential impact of the Fed's NPRs now that you have had more insight looking at that? Also just going into CCAR for 2013 if any thoughts about maybe your approach and if it would be any different than last year?

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

In terms of the NPRs, the Basel III estimate that we have for Tier 1 common equity takes into consideration a relatively conservative implementation of those. So the 8.02% number we feel is a pretty solid number based upon what we know today. We haven't gotten any further updates or indications just because it is a work in process right now.

As it relates to CCAR, we are really looking forward to going through a CCAR and we are looking forward to presenting our submission in the first quarter, because it is the way that we can continue to increase our capital return to our shareholders. As you know, we had a very successful CCAR process this last year and our expectations are we will have another successful one.

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

Let me reiterate what Tim just said which is really important; we are really focused on getting more capital back to our stockholders. That is -- and the best way to do that is perform well, as we are doing, and have the capital we have. Tim said, it is a lot of work the CCAR but we are looking forward to it.

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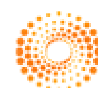

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Joe Morford - *RBC Capital Markets - Analyst*

Okay, that's helpful. Thank you.

Operator

Scott Siefers, Sandler O'Neill.

Scott Siefers - *Sandler O'Neill - Analyst*

I guess I just wanted to ask another question on the margin. I guess was there anything that sort of like surprised you in September I guess just relative to where you had been suggesting a month or so ago that it would be. It came in a little worse than that guidance.

And then I guess along those lines, I think in the past you have been pretty clear that you expected the margin to come under pressure, but by the same token, had hoped that the NII would be able to continue to grow. Do you think you can, off of this quarter's base, still generate positive NII growth?

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

So a few questions in there and all good ones. The first one, our deposit growth was a little bit stronger in September than we had expected, which again is terrific. That is the way that we get most of our customers into Wells Fargo so we are happy with that. And, secondly, we had fewer resolutions than we had estimated.

But I think it is really important to step back and just reflect on what has happened with our net interest margin over the past year. Certainly the 25 basis point decline this quarter is high, but when you think about it year over year our net interest margin is down 18 basis points.

So when you think about what has happened during that year, on a net interest margin decline of 18 basis points our net interest income is up 1%, we have grown deposits by $51 billion, we have originated $519 billion of residential mortgages, our efficiency ratio has improved from 59.5% to 57.1%. And so when you total all this up -- I am sorry, and credit has improved. Even adjusted for the OCC guidance, our loan losses are down 50 basis points.

I say all that because, while net interest margin is an important factor to look at, what we really focus on is earnings per share and earnings per share are up 22% over that same period. And I think that really reflects the strength of our diversified model.

There is no question that in this low rate environment the NIM will continue to be under pressure. Again, we don't believe that. The 25 basis point decline that we saw this quarter is representative of what we will see in the future, but what we do believe is that our performance is going to be representative of what we are going to see in the future because we have got a very strong diversified model.

And in answer to your last question, I do believe that we can grow net interest income over time even in the face of a declining net interest margin.

Scott Siefers - *Sandler O'Neill - Analyst*

Okay, perfect. That is helpful color, I appreciate it.

Then I just wanted to switch back to the decision to portfolio some of the conforming mortgages as well. I definitely understand the rationale relative to some of the other investment alternatives that you would have, but I guess by the same token putting on mortgages at historically low rates potentially introduces some [rate] risk of its own in the future. How did you kind of square that dynamic when you guys thought about it?

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

Yes, I think that is a very fair point or a good question because any time we put any asset on the books we have got to think about the risks. It is not only about what kind of return we can get in the short term, but it is about the risk of owning that asset, whether it is a loan or a security or whatever.

And so, in making this decision, we took into consideration interest rate risk, credit risk, as well as concentration risk. We are very comfortable, given the size of our loan portfolio and the level of our liquidity and the level of interest rate risk that we have at the company, that this incremental increase of $9.8 billion and the incremental mortgages that we mentioned that we will likely put on this quarter on the balance sheet is not going to significantly or materially affect interest rate risk or credit risk.

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

The thing about it is we have done this in the past. Again, it is one of the tools that we have, one of the levers we can pull, and we see a very nice difference between the yield there versus if we bought RMBS as a security. Again, there you are paying 105 or 106. You are paying a premium and if those things pay off early you have that premium amortization, so there is a lot of balancing here.

But we have done this before, we are aware of that. It is something we think about.

Scott Siefers - *Sandler O'Neill - Analyst*

Good, perfect. Thank you very much.

Operator

Ed Najarian, ISI Group.

Ed Najarian - *ISI Group - Analyst*

Good morning, guys. So a couple of quick questions here. Just first in terms of retaining the conforming fixed rate mortgages, the $9.8 billion, why is that a better decision than maybe retaining jumbos that might have a higher yield and have equal or better credit quality?

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

Oh, Ed, we do that too.

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

Absolutely.

Ed Najarian - *ISI Group - Analyst*

But given your giant origination volume, can't you just do more of that versus 30-year fixed conforming?

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

Well, we would like to do more of that and we have got a very strong nonconforming or jumbo origination capability and we want to and will continue to grow that. But in addition to that, we thought it was a good idea, given the risk/return alternatives, to hold these conforming mortgages too.

And this is just an example of how we think about managing the Company for the long term. I mean we could have taken that $9.8 billion and had a gain on sale, which would have been fine and increased the short-term earnings. But we thought it was better to hold these high credit quality mortgages to generate income over a longer period of time.

And, again, we retain all of our nonconforming jumbo mortgages. We do not sell those.

Ed Najarian - *ISI Group - Analyst*

Okay. Then given what you have done to sort of the overall accretable yield balance, taking that number up to almost $19 billion, what you talked about previously, should we expect $495 million of quarterly accretable yield through NII to be a higher number in future quarters?

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

It is going to be higher. I would describe it as being slightly higher, because it is over a longer period of time, 13 years, plus there is the disproportionate return that comes toward the end of the term of those mortgages. But there is no question it will have a slightly positive impact on the net interest margin.

Ed Najarian - *ISI Group - Analyst*

Okay, thanks. Then this question is, again, kind of specific to the margin.

Looking at your C&I and your real estate mortgage yields, sort of prepared for the big drop in the commercial real estate mortgage yield from 4.60% to 4.05% because I think that was obviously inflated in 2Q from the cash recoveries. But we also saw a pretty big drop in the yield on the C&I portfolio itself.

Is there something going on in there other than the rate environment and competition? Was there some cash recovery in there as well in 2Q?

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

There was a little bit of cash recovery in the second quarter. Again, you also have the impact of the liquidating portfolio kind of running off, but I wouldn't -- and, again, if you look back on even a five quarter basis you have seen some volatility in that number. We also -- there was also an impact from some lower loan recoveries that we got in the second quarter, but I wouldn't necessarily look at that decline -- the level of that decline as a trend.

Ed Najarian - *ISI Group - Analyst*

Okay. Would you feel like that 3.84% number on the C&I yield is something that should remain more stable going forward?

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

Gosh, I hope so. There is no question that there is a fair amount of competition out there for assets. But, again, I don't think you should look at the 4.21% to the 3.84% as a trend that you are going to see on a quarterly basis. There certainly could be some impact and some future decline, but the 3.84% number feels pretty good.

Ed Najarian - *ISI Group - Analyst*

And then lastly and I will stop, on operating costs probably absorbing clearly some extra costs related to the strong mortgage origination pipeline and volume. Can you maybe frame operating expenses for us over the next few quarters sort of in two pieces? Number one, what we might see in terms of core expense reductions apart from mortgage, and number two, what we might see in terms of savings on the mortgage side as the refi volume ultimately comes down.

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

Well, our guess is it relates to the -- and our best estimate in terms of refi volume is that that is going to continue on for a few quarters. So I don't expect any sort of decline in expenses until that occurs. Again, I doubt it is going to be next quarter or the quarter after that.

In terms of other expenses, clearly when you look at the mortgage business we have other environmental expenses that are elevated for things like the consent order, the servicing settlement, and just the fact that while the portfolio has continued to improve we still have higher than normal costs. My guess is that those are going to begin to tail down sometime probably in the second half of next year.

And in terms of then just the base operating expenses, as John mentioned, as I mentioned, we are continuing to look at expense reduction in the Company but we want to do it in a way that is very focused on the efficiency ratio. Because in this environment, while we want to be more efficient, we don't want to give up good revenue opportunities.

John, I don't know if --

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

Yes, let me maybe expand on it a bit. Ed, you are asking the right question. We still think expenses are too high here, but we have also said we are not going to be slavish to a number and turn away revenue.

So if we look year over year compared to third quarter of 2011, we are up now in expenses of $500 million but are revenue is up $1.6 billion. So we think that was a good trade.

That being said, we can be more efficient. There are some expenses that we are getting through compliance and consent and other things that we will get better at, that will go away. But even in spite of all of that we still think we have -- our operating assets are too high and we are focused on that.

But we want to do it smartly, and a 57% efficiency ratio we have come a long way from the low 60%s. We have picked up 240 basis points in a year and we still think we have more room to go. And it is well within our guidelines of 55% to 59%.

Ed Najarian - *ISI Group - Analyst*

Okay, that is very helpful. Thanks, guys.

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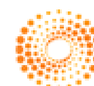

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Operator

Andrew Marquardt, Evercore Partners.

Andrew Marquardt - *Evercore Partners - Analyst*

Good morning, guys. Just back to the margin commentary, can you help us frame just kind of the magnitude of how much pressure we should still expect going forward after the re-stepping down to the 3.66% range? Is it going to be in the 5 to 10 range, or how do we think of the output given the number of moving parts still?

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

Yes, I know it can be a little bit frustrating to try to predict any sort of decline in the net interest margin, and part of that is because on a quarterly basis it can be pretty volatile. I mean if you look back a year ago in the third quarter our net interest margin was down 17 basis points and then it was up in the fourth quarter and then it was flat for a couple of quarters.

So if you step back and look at it year over year at being down 18 basis points, could we see another 18 to 20 basis points decline in a year? Sure we could. Could it be up to 25? You bet. Could it be 15?

And so you could see that much change, but we could also see another quarter in the next quarter where it is up. Again, what we focus on is not managing to the net interest margin. Again, the reason for that is the following.

We could have easily increased our net interest margin by making some bad short-term decisions. For example, we could increase the duration of our investment portfolio.

We could go out and buy a lot of securities that have good short-term yield but have higher credit risk. That may be a good short-term decision in terms of managing to the net interest margin. It could be a bad long-term decision in terms of how we are managing this company for the long term, which again is why we don't spend a whole lot of time being focused on managing to that margin.

But, again, back to the original question, could we see the same kind of decline year over year that we have seen this year? We certainly could.

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

On the other side, think of it, the other half of our revenue comes from noninterest income and we have shown very good growth in that area. So even though -- as we gain new households, new customers, if they are not borrowing or if spreads are lower there we do a lot of other things with these folks and we have seen good growth in that area. So overall revenue year over year up 8%. Those are pretty good numbers.

Andrew Marquardt - *Evercore Partners - Analyst*

Got it. And did I hear correctly from the earlier question, I think it was Scott who asked, that the NII should and can improve from here despite the pressure on a linked-quarter basis?

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

Yes. Yes, absolutely.

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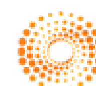

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Tim Sloan - *Wells Fargo & Company - Senior EVP & CFO*

Sure.

Andrew Marquardt - *Evercore Partners - Analyst*

Okay. And then is the margin pressure, is this going to last for you and it feels like the industry through next year as well if this current environment remains?

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

Yes.

Andrew Marquardt - *Evercore Partners - Analyst*

Then on expenses, the target of 55% to 59%, should we think about that being a target for next year as well?

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

Yes, you know it's good, that is a good question. We announced the 55% to 59% at investor day in May and we did it at investor day because we didn't want that to be viewed as a range that was for one quarter or two quarters. That is the range that we believe that we can operate in.

Again, there is going to be some seasonality in our expenses. Our expenses are generally up a little bit in the first quarter because of compensation related items, but we think that we can operate it within that range and we will be using that range for the time being.

Andrew Marquardt - *Evercore Partners - Analyst*

Great, thank you.

Operator

Matt O'Connor, Deutsche Bank.

Matt O'Connor - *Deutsche Bank - Analyst*

Good morning. I wanted to follow up on something, Tim, I think you just said about the mortgage-related costs related to like legacy assets, or the environmental costs, as you referred to them. You said something about hopefully they will start to tail off back half of next year.

I realize that is probably somewhat of a guesstimate, but why is it taking so long for those costs to come down with home prices rising and some more guidelines on the servicing side? Like why do you think it is good to be another year before we see a meaningful decline in those areas?

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

Let me separate them into two groups, Matt. There are the costs that are related to just managing the portion of the problem loan portfolio, whether it is in mortgage or anywhere else within the Company. And those are continuing to come down. So I didn't mean to imply, and apologize if I did, that we are -- we don't think those are going to come down until next year.

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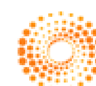

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The costs that I was referring to are what I would describe as the environmental costs related to complying with the consent order and also the servicing settlement. Those are works in process right now and it is going to take us through next year to be able to kind of work through the servicing settlement and comply with the consent order.

So there is really kind of two different categories, Matt.

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

For example, the new servicing standards just became effective, I think, October 1. I mean we had front run at that, but it takes a while to get those really worked into your system and become efficient on those.

Matt O'Connor - *Deutsche Bank - Analyst*

And how much are the costs -- how much are those, the consent and servicing related costs in the third quarter?

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

What we disclosed in the supplement, Matt, is that the third-party costs related to the consent order about $100 million a quarter. As it relates to the costs for the servicing settlement, we didn't disclose those but assume there is some addition to that.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay. So I guess the bigger portion, though, is just the cost of servicing some of the troubled borrowers. That part is coming down, because I would think that the biggest piece of (multiple speakers)?

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

That will continue to come down as the portfolio continues to improve, which is what we have been seeing.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay. Then just separately on the mortgage side, how elevated are the production-related expenses? Just like in absolute dollar what are those costs this quarter?

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

Matt, I am not going to disclose that because then everybody would know exactly what our margins are and that is an important from a competitive standpoint.

Matt O'Connor - *Deutsche Bank - Analyst*

Is there anything you can size around? Like, year-over-year expenses are up X and X percent of that is due to higher mortgage, or any way to frame it a little bit for us?

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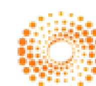

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Tim Sloan - *Wells Fargo & Company - Senior EVP & CFO*

No.

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

I can tell you this, that it takes more time now to underwrite a loan. I mean there is more expense on that but we are working through those things.

Matt O'Connor - *Deutsche Bank - Analyst*

I mean I guess just at a very high level it seems like there is some puts and takes on the production-related expenses. A lot more leg work needs to be done to get loans approved, whether it is refi or purchase, yet I think the headcount add has been a lot less to the industry and technology is better.

So it is just hard to put it all together. I mean it seems like there is some elevation on expenses but maybe not as much as, say, a few years ago when hirings were more meaningful.

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

Matt, I think it is a really fair question, and in fairness to the entire industry or anybody that is in the mortgage business today, there is a lot of change that is going on. And so I think it is hard to kind of put a hard dollar cost to this has really been what the impact of the change, because it is still a work in process.

I would have you step back and just, again, focus on the overall efficiency ratio for the Company which has continued to improve over this last year, as John said, by about 2.5% and even in the last quarter by over 100 basis points.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay.

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

But we are adding people to deal with volumes and to get the throughput.

Matt O'Connor - *Deutsche Bank - Analyst*

And you don't disclose the headcount in the mortgage company do you?

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

Not separately, no.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay. All right, thank you.

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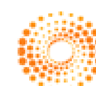

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Operator

Ken Usdin, Jefferies.

Ken Usdin - *Jefferies & Company - Analyst*

Thanks guys. Good morning. Just one more kind of all-encompassing question on expenses.

So understanding the efficiency ratio points that you make at the top of the Company and the progression that has been made with total expenses continuing to come down for the last couple of quarters, can you give us a framework of how to just think about the overall expense base just going ahead? Because I would think you still have some annualization of the cost-saving programs, you have got the environmental costs that Matt just asked about, and then there is this unanswerable question right now about how much is in the mortgage business.

So can you just help us frame how you're going to be thinking about just the overall cost base from a dollars perspective as we think about 2013 over 2012, just from an operating leverage perspective?

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

Well, I think you made an important point there at the end and that is we are looking at operating leverage and we are looking at efficiency ratio. And so we are not focused on saying, look, here is hard dollar reduction that we want to see year over year. What we want to see is we want to see sequential improvement in our efficiency ratio.

Now, again, the first quarter in every year is going to be a little bit different, but the way that we are measuring our people, we are measuring the businesses is to see that sequential improvement in the efficiency ratio. So we don't have a specific dollar target for next year, but we want to improve the efficiency ratio so we can get down to stay in the middle to get down to the lower end of the range that we set.

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

And I would also say that we want to make sure that for businesses like mortgage that have volume differences, one year it could be much higher [than another]. When volumes do ebb or the business contracts we want to be able to adjust expenses in a similar way. That is extremely important in that business.

Ken Usdin - *Jefferies & Company - Analyst*

So I guess the broad takeaway is that next year you would still see the ability to improve the efficiency ratio from where it currently stands?

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

Oh, yes. Again, what we are looking for -- the way that we measure our businesses internally is to look for sequential improvement in operating leverage. In every business, regardless of what the business is.

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

Absolutely.

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

So that it takes into consideration not only the revenue opportunities that the businesses are seeing, and you have seen that in our results this quarter across the board in many businesses, but also asking them to become more efficient at the same time.

Ken Usdin - *Jefferies & Company - Analyst*

Okay, got it. My second question is just about the trust and investment fees business. Obviously had good sequential improvement. I was just wondering if you could provide a little color about the momentum you are seeing there.

Also, obviously the summer was a tough environment on the volumes-based side of things but there was still growth in the business. So are we seeing an incremental bit of momentum there in the core business? And just any changes you are seeing in terms of customer activity and the outlook for growth in that part of the Company?

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

I think a couple things. One, we did see and we are continuing to see some momentum there. I think David Carroll at our investor day did a terrific job in kind of walking you through the opportunities that we see in that business -- in his business.

Then in our investment banking business John Shrewsberry did a nice job of kind of walking you through that at investor day. So we are seeing some good momentum.

And I think the other thing that is really important when you think about the trust and investment fees is that the mix is also improving so that we are seeing more of the mix coming from advisory fees and asset management fees as opposed to just transactional activity. So we are optimistic that we can continue to grow, not only within those businesses but also that line item.

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

Part of the secret sauce there is David and his team's ability to work across businesses within the Company. So he works very closely with the community banking side led by Carrie Tolstedt, very closely with Dave Hoyt and his wholesale side, so there is lots work together because many of our customers who call us their bank keep their wealth someplace else. So we have huge opportunity in this business.

Ken Usdin - *Jefferies & Company - Analyst*

Okay, great. Thanks, guys.

Operator

Paul Miller, FBR.

Paul Miller - *FBR & Co. - Analyst*

Thank you very much. I hate to go back to the NIM, but I wanted to talk a little bit about the securities portfolio. It did increase a little bit, but what type of -- and you talked about this in the opening remarks about some of the NIM pressure coming from the securities portfolio.

But what type of CPR rates are you seeing? I know you have some really high-yielding stuff that is probably prepaying very fast.

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

You know what, Paul, that's a fair question. I don't have the CPR rates on an individual security basis handy. We can get back to you with that.

Paul Miller - *FBR & Co. - Analyst*

Okay. Then the other question is -- can you at least tell us where it is coming on? Is it coming on in the $1.5 billion once the new stuff is coming on board?

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

Well, there is no question that we saw some increase in the CPR levels in some of the newer securities, but again we will get back to with some more detail.

Paul Miller - *FBR & Co. - Analyst*

No, I understand. What yield are you buying new securities on?

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

Oh, what yield. I am sorry. It is whatever the yield is today in the market.

I think that the more important point is that we -- when we saw rates decline significantly and then we saw the demand for the underlying securities really increase so that you were looking at buying these at a significant premium, that is the point at which we said, you know what, this just doesn't feel very good to us in terms of making a long-term decision and where we focused on keeping more of the conforming mortgages.

Paul Miller - *FBR & Co. - Analyst*

Okay. And one real quick question. What is -- you might have it somewhere, but I can't see it. What is your annualized servicing fee?

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

Our annualized servicing fee?

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

On mortgage?

Paul Miller - *FBR & Co. - Analyst*

No, on the -- for your servicing portfolio. I'm sorry, guys.

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

63 basis points? You mean the valuation?

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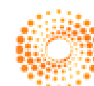

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Paul Miller - *FBR & Co. - Analyst*

No, that is your capitalized cost of servicing. Your annualized servicing fee.

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

The 25 bps?

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

It's 25 basis points.

Paul Miller - *FBR & Co. - Analyst*

Okay, thanks a lot, guys.

Operator

Mike Mayo, CLSA.

Mike Mayo - *CLSA - Analyst*

My question is on mortgages past, present, and future, so let's start with the mortgages past. I mean the decision to retain the mortgages on the balance sheet; do you still have the option to sell those retained mortgages? Because you are passing up some revenues today, it is tying up more capital, and there is a trade-off there, isn't there?

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

Sure, there is and we think it is a good trade-off to make today. But holding these mortgages today doesn't preclude our ability to sell them in the future.

Mike Mayo - *CLSA - Analyst*

So you could sell them today or in a month or in three months, you think?

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

Well, I don't think we could sell them tomorrow, but we could sell them in the future certainly.

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

You have to securitize them.

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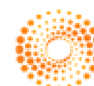

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Tim Sloan - *Wells Fargo & Company - Senior EVP & CFO*

You got to get them wrapped, but, yes, we could do that.

Mike Mayo - *CLSA - Analyst*

And then as far as the mortgages today, you said the applications were down from the second quarter to the third quarter and you might have thought with QE3 the application volume would have increased. So what has the application volume done from the end of the third quarter until today?

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

Well, let me parse your mortgage present for a minute. The pipeline at the end of the third quarter was down slightly from the end of the second quarter by I think $5 billion or $6 billion. It is still very high.

Our mortgage volume in the third quarter was higher than in the second quarter. And maybe this gets into a little bit of the mortgage future, what we are seeing so far this quarter is that volume is up.

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

And remember we got out of the wholesale business in the third quarter.

Mike Mayo - *CLSA - Analyst*

All right. So volume is up so far this quarter versus the second quarter, so that should be good for the fourth quarter?

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

I hope.

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

If it continues.

Mike Mayo - *CLSA - Analyst*

Okay. But the more general question for the future, you said this should last maybe a few more quarters as far as the mortgage boom in terms of the revenues but then it falls off. So my question is could you offset that fall off entirely through actions at the mortgage company, or would that be where the diversified model comes into play and you would expect other business lines to pick up the slack?

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

Well, there is a lot of variables in the question you just asked. What is the economy going to look like, where are interest rates going to be? But I think what you have seen this quarter, and not only what you have seen this quarter but what you have seen for the last few quarters and the last year, is that because we have got a diversified model you are seeing growth in a number of businesses.

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I can't promise you that the quarter that we see a decline in the mortgage business that every one of those businesses is going to be able to pick up the complete slack. I hope it does. That is what we have seen historically when we have gone through these peaks and valleys in the mortgage business, but, again, that is the benefit of the model that we have got in that we have got other levers to pull. There is other horses that are pulling the stagecoach.

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

And, Mike, another thing you have to think about is 75% of our mortgage volume this past quarter was refinance and 25% was purchase money. That is still a very low overall purchase money market as we see real estate continue to improve, as refis ebb, we might see the purchase volume pick up. So that is a natural offset.

Furthermore, as the purchasing volume or if rates rise and those things slow down, then the servicing asset becomes more valuable. So we have all those things going on besides the diversified model.

Mike Mayo - *CLSA - Analyst*

But at the end of the day, even with the improvement in the servicing assets, even with more purchase volume, even with the expense cuts in the mortgage unit, chances are you would still have to rely on some, as you would say, horses outside the mortgage area?

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

You bet, absolutely. That is the exciting part. We feed them all; they are all pulling.

Mike Mayo - *CLSA - Analyst*

Just last follow-up, because this is the main question I think, how you manage to hand off from the mortgage boom to the time you cut the expenses? How do you know when to start cutting those expenses? What signs are you looking at?

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

Well, the mortgage business, as you could imagine, this is not the first -- we have been doing this a long time. We have terrific leaders there and they see volumes on an -- not on an hourly but a daily basis, and they have been very good at dialing up and dialing down to adjust to volumes.

Now there is, surely, a fixed component there. But we have done this -- this is not the first up or down we have seen in this business. We have seen many of those.

Mike Mayo - *CLSA - Analyst*

But isn't this time different? I mean if we have QE4 that could change your whole analysis, right? Isn't this (multiple speakers)

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

Well, Mike, you are exactly right. We didn't know QE3 was coming and now we are adding people. And if QE3 lasts, if the volumes last for 12 months versus six months we will make adjustments up or down based on that.

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Mike Mayo - *CLSA - Analyst*

Are you able to say how many people you have added?

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

I don't think -- no, we have not said that but we are adding people.

Mike Mayo - *CLSA - Analyst*

Okay. All right, thanks a lot.

Operator

Greg Ketron, UBS.

Greg Ketron - *UBS - Analyst*

Good morning. I guess a variation of all the mortgage questions that you have answered this morning. Kind of looking out into 2013 the MBA forecast calls for volumes to be off maybe 20% to as high as 30%.

I know that MBA forecast is about as accurate as a weather forecast, but if you look at that type of scenario are there things that you can do, maybe on the pricing side or product side, and increase market share in light of a scenario that would have mortgage production coming down that much?

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

Well, I mean, yes. You could always lower your prices and take up share, but I don't necessarily think that is a good decision. Always going to be a good decision from a profit standpoint.

It is a very competitive market out there. We don't run the business based upon share; we run the business based upon profitability. Our first call continues to be focused on our retail origination network and then also, secondly, our correspondent network.

As you said, the MBA forecast it could be right, could be wrong. I think everybody has been surprised at how long this refinance boom has lasted. As I said, we think it is going to last for a few more quarters and, again, at some point it is going to slow down.

As John said, there might be a mix change. We hope there will be and there will be more purchase money mortgages.

But, again, the important thing is we have been through this before. This isn't something that the folks in our mortgage business or the management team at this company hasn't seen before in terms of cyclicality in the mortgage business, and we will adjust to it.

Greg Ketron - *UBS - Analyst*

Great. And then in terms of the -- I'm sorry.

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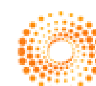

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John Stumpf - *Wells Fargo & Company - Chairman, President & CEO*

I was just going to add, remember on our mortgage business half of our business is through correspondents. So the adjustments we need to make is really on a 16% share or something.

Greg Ketron - *UBS - Analyst*

Okay, great. In terms of what you are seeing maybe so far this quarter, we know if you look at the primary to secondary mortgage spread that widened out quite a bit, especially after QE3 was announced. Is it your sense that you are to continue to see mortgage rates work their way down and maybe some pressure on that spread than the fourth quarter?

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

You know, I don't know the answer to that. Clearly the spreads are attractive today. The costs are up, too, and the GC was up also. We are hopeful that the margins will continue to be at their present level, but it is competitive out there.

And I think the one thing we know from history in the mortgage business is that when you're at a high level of margin there generally tends to be more pressure down than up. Again, it is competitive but it is a very attractive business for us to be in. We are really pleased we are originating one of every three mortgages that is done in the country.

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

And it is also a very good deal for consumers. I mean consumers are getting bargains these days if you look at the rates on the street. This is very -- and this is probably the best time ever to buy a house, most affordable.

Greg Ketron - *UBS - Analyst*

Right. Well, thank you very much.

Operator

Betsy Graseck, Morgan Stanley.

Betsy Graseck - *Morgan Stanley - Analyst*

Question on the nonperformers. It is just another way of getting at the expense question, because obviously you have got carrying costs associated with nonaccrual and foreclosed assets.

I am just wondering about how much more rapidly we could expect you would try to bring this balance down. We have had a change in the short sale program from the FHFA, which I would expect would be one opportunity to accelerate this shrinkage, but maybe I am wrong there. Maybe you could give us some color on what your thoughts are.

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

Sure. Betsy, I think if you look at kind of that five-quarter chart that we had in the supplement and go back to the third quarter last year, our total nonperforming assets were about, I am going to round here, about $27 billion. The improvement over the last year has been pretty significant with the exception that we have had the OCC guidance in the first quarter and then in this quarter that raised it.

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What we are seeing is $1 billion-plus decline in NPAs, more or less, on a quarterly basis, absent that guidance. And our expectation is that it is reasonable to assume that that can continue.

Betsy Graseck - *Morgan Stanley - Analyst*

But could you do anything to accelerate that?

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

We could. And we look at that all the time in terms of what is the best economic return for the Company. Not necessarily driven by ratios but -- yes. And so not only do we look at working out loans on a loan-by-loan basis, but also in the past quarters we have sold packages of nonperforming assets. We will continue to look at that and if the economics are there and if the economics get better then we could certainly accelerate that.

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

Tim is right about that. It is based on economics. I mean we don't feel there is any reason to do something that is uneconomic, but if it is economic that would be terrific.

Betsy Graseck - *Morgan Stanley - Analyst*

Sure. Does the short sale rule change anything in terms of helping you accelerate this or not really?

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

Not really.

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

Not really. Because most short sales never get to the balance sheet, right? I mean if it is -- many of those are done on behalf of our investors so it doesn't spend much time, if anything, in your NPA area.

Betsy Graseck - *Morgan Stanley - Analyst*

Right. Okay, thanks.

Operator

Chris Mutascio, Stifel Nicolaus.

Chris Mutascio - *Stifel Nicolaus - Analyst*

Good morning, John and Tim. How are you?

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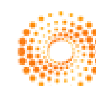

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John Stumpf - *Wells Fargo & Company - Chairman, President & CEO*

Hey, Chris.

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

Good morning, Chris. How are you doing?

Chris Mutascio - *Stifel Nicolaus - Analyst*

I am doing well. I promise I won't ask you a margin or a mortgage question.

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

We are getting pretty good at them (multiple speakers)

Chris Mutascio - *Stifel Nicolaus - Analyst*

Yes, you could do a debate, I think, given all the prep you have had.

I am looking at your cash and your Fed funds sold at the end of period. You are almost up to $120 billion, pretty darn close to 9% of your total assets. I understand you had mentioned you are more prudent in terms of reinvestment right now given where rates are.

My question is, though, it looks like you are hoarding cash a bit though. Are there any opportunities out there for a typical, the type of loan pool purchases you have made in the past? It has been kind of slow of late. Are you seeing any type of ramp up in those opportunities out there?

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

You are correct. We didn't have a medium-size or large acquisition that we did this quarter like we have had over the last few quarters. I wouldn't necessarily conclude that that is a trend; that we won't continue to see those.

We still have a pretty robust pipeline of opportunities out there and so we are not necessarily hoarding cash to make sure that we have got the ability to do it. Because even if we had $20 billion or $30 billion less of cash, we would be more than liquid enough to be able to accomplish an acquisition.

We will continue to be very focused on looking at good acquisition opportunities. We are very pleased with what we have been able to accomplish in the last year and we are hopeful to see -- that we will continue to see those types of opportunities. But the pipeline is still there.

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

Yes, and I would say that the level is more because we can't -- the opportunities are not -- the risk/reward is not the right kind of thing and we haven't found anything that makes sense for us. But if it would be half that I would be -- if we could find a great asset that would be great. We didn't pick that number per se.

Chris Mutascio - *Stifel Nicolaus - Analyst*

Thank you very much. Have a great weekend, guys.

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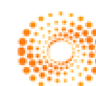

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Operator

Marty Mosby, Guggenheim.

Marty Mosby - *Guggenheim Securities - Analyst*

Good morning. I want to take us back into the margin and mortgage just for a second, but a little different twist.

If you are looking at the variable income, what I am trying to figure out is if you net the five quarters over this period of time you end up with a negative 5 basis points. So in general you know you (technical difficulty) start at some point.

I am just curious, you say that -- would you think that the resolutions are lower than normal, abnormal? Kind of where are we at going forward on that particular item?

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

Marty, for this quarter the resolutions were a little bit -- were clearly lower than what we have seen in the last four, five, six quarters.

Marty Mosby - *Guggenheim Securities - Analyst*

So you would -- because I was looking at them last quarter. They were obviously elevated, but if you look back over time that was more than compensated with the drop off that you had in this quarter.

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

That is correct.

Marty Mosby - *Guggenheim Securities - Analyst*

Okay. And then when you look at mortgage, one of the things that is interesting to me is as you look at the roll-off of the income that you are getting there, one of the things that helps cushion that blow is in periods when you have higher revenue potential you find ways to kind of offset that. So in other words, if you look at holding the mortgages that would have lowered to revenues by, like you said, a little bit more than $200 million.

In this quarter you adjusted your servicing costs and you incorporated a higher cost going forward; that lowered the number by 482. So if you look at those two adjustments that were kind of incorporated in the $2.8 billion, there was a potential to earn $3.5 billion, which is about 20% higher, 20% to 25% higher than what you actually earned. So part of being able to cushion the future run-off is that you just kind of shave some of the peak off which helps cushion the blow later on.

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

Well, you are correct, Marty, particularly as it relates to the decision to hold the conforming production and keep it on balance sheet and to have that income flow over a longer period of time. During the term of the mortgages as opposed to recognize it as gain on sale. So, yes, I mean there is no question that when you look at the mortgage business today it is very strong.

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Marty Mosby - *Guggenheim Securities - Analyst*

And just all of it is not flowing to the bottom line because of the couple of things that happened in the sense of the servicing costs and holding the mortgages. So you could have recognized if every quarter you are not going to have servicing costs be adjusted higher. That is not something you normally do.

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

I certainly hope -- I hope that that is correct, Marty, but we did this quarter. We thought it was prudent to do it, but I hope we don't have a repeat of that in the next few quarters.

Marty Mosby - *Guggenheim Securities - Analyst*

Then just kind of lastly, putting all that together down to -- if you think of the decision you made to hold more mortgages, the decision to hold more liquidity, you are going through a process of kind of storing up revenues that you can deploy at a better time down in the future. So the length and the life of that mortgage that you held will give you income through the cycle and over the next probably seven to 10 years.

If you look at the liquidity, when interest rates eventually begin to rise, which is when refis come down, you can deploy that at the much more advantageous time and create some positive there. So just on those two decisions that you have tangibly made there is about $0.04 of earnings in this quarter that helps future earnings down the road.

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

Marty, that is a great summation of how we think about the Company over the long term. We have got to make good long-term decisions every day as opposed to let's make a good short-term decision that doesn't have a good long-term benefit. And so that is exactly how we think about managing this company.

Marty Mosby - *Guggenheim Securities - Analyst*

My past history is -- I think the way that this works the best is managing the quarters in which you have extra earnings for future, investing into the future, versus really taking the weaker quarters and trying to prop them up. You make the most traction in creating future earnings streams by taking those peaks and putting them out into future quarters. So I appreciate it.

Operator

Chris Kotowski, Oppenheimer.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

My question was actually asked about 12 different ways, so we can call it a day. Thanks.

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

All right, thanks, Chris. Appreciate it.

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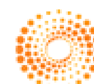

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John Stumpf - *Wells Fargo & Company - Chairman, President & CEO*

Well, thanks, everybody, for joining us and your interest and the way you follow our company. We will see you at the end of the fourth quarter. Thank you very much. Bye-bye.

Operator

Ladies and gentlemen, that does conclude today's conference. Thank you all for participating and you may now disconnect.

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