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EDITED TRANSCRIPT

WFC - Q1 2013 Wells Fargo Earnings Conference Call

EVENT DATE/TIME: APRIL 12, 2013 / 2:00PM GMT

OVERVIEW:

WFC reported 1Q13 earnings of $5.2b and EPS of $0.92.

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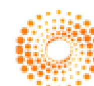

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PRESENTATION

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 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 - 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 discuss first-quarter results and answer your questions.

Before we get started I would like remind you that our first-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. 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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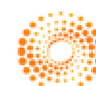

Information about any non-GAAP financial measures referenced, including a reconciliation of those measures to GAAP measures, can also be found in our SEC filings, in the earnings release, and in the quarterly supplement available on our website. I will now turn the call over to our Chairman and CEO, John Stumpf.

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

Thank you, Jim, and thanks, everyone, for joining us today. In the first quarter, Wells Fargo generated another record quarter of earnings and we achieved our 13th consecutive quarter of earnings per share growth. We have achieved these results by doing what we have always done -- remaining focused on meeting the financial needs of our customers and helping them succeed financially.

We accomplished this in an environment that I think we would all agree wasn't ideal for generating earnings growth, demonstrating the benefit of our diversified business model. Our business is diverse in many ways. We are geographically diverse; we have over 80 different businesses that perform differently in various economic environments; and our revenue is split fairly evenly between interest and non-interest income. That kind of diversity lowers risk and enhances earnings stability and growth.

Let me start by highlighting examples of our strong performance in the first quarter compared to a year ago. We earned a record $5.2 billion, up 22%, and also grew our earnings per share by 23%. We reduced our expenses and improved our efficiency ratio by 180 basis points to 58.3%.

Our core loan portfolio grew by $50.9 billion, up 8%. Our credit losses reflected the benefit of a slowly improving economy and the high quality loans we have been originating over the past few years. Our credit losses in the first quarter declined to 72 basis points, the lowest level since second-quarter 2006, and our net charge-offs were down 41% from a year ago.

We also continued to benefit from our wonderful deposit franchise, growing deposits by $80 billion, up 9% from a year ago, while reducing total deposit costs by 5 basis points. Our growth reflects the benefit of our relationship model, as demonstrated by achieving record Retail Banking cross-sell of 6.1 products per household. We also grew Wholesale Banking cross-sell to 6.8 products, and Wealth, Brokerage and Retirement cross-sell increased to 10.3 products.

We grew our return on assets, or our ROA, by 18 basis points to 1.49%. And our return on equity increased by 145 basis points to 13.59%.

We continue to increase our capital levels, growing our estimated Tier 1 common equity under Basel III to 8.39%. Returning more capital to our shareholders remains a priority, and we are extremely pleased that we were able to reward them in the first quarter by increasing our common dividend to $0.25 a share. Our 2013 Capital Plan enables us to further increase our dividend rate to $0.30 a share in the second quarter -- subject, of course, to Board approval -- and also increase our common stock repurchases in 2013 compared to our 2012 repurchase levels.

We are obviously off to a great start in 2013, and I couldn't be happier with the ability of our team members to continue to make more loans and grow deposits, increase cross-sell, and reduce expenses, all while we continue to invest in our franchise and adhere to our risk management discipline.

Let me conclude by taking a moment to share my thoughts on some industry issues and our current view on housing. A topic that has been in the headlines a lot lately is important to Wells Fargo, our industry, and the economic recovery of our country; that is, Too Big to Fail. I believe our first priority as a country, given the economy's tepid growth, is restoring economic health to America, including consumers and businesses large and small.

Banks fuel and support economic growth, and we need banks of all shapes and sizes to serve the diverse needs of a diverse economy. All banks add value, and big banks have unique resources and capabilities to help the economy, including coast-to-coast convenience, a broad range of products and services and technology innovations serving large and small customers alike.

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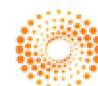

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There are ongoing discussions about the need for more regulation and other changes. We do not need additional legislation aimed at big banks. Important and significant regulatory changes have been made since the financial crisis, and we need to give existing regulations a chance to work, especially now, when all of our energy should be focused on creating growth and new jobs.

No bank should be considered Too Big to Fail, and no taxpayer money should ever be used to support a failing institution. Some claim that we receive a subsidy or have an unfair advantage from being perceived as Too Big to Fail. We disagree.

Wells Fargo supports economic growth in our country in a variety of ways including employing 1 in 500 working Americans and paying more than $10 billion in corporate income taxes last year. We are the nation's largest small-business lender, and increased new loan commitments to small businesses by 24% in the first quarter compared with a year ago, and have grown loans to our middle-market consumer customers for 11 consecutive quarters.

We also funded one in four US home mortgages in 2012, a total of over 2 million mortgage loans, that helped our customers buy a home or refinance their existing home at much lower rates. This is great for the overall economy, because housing has led almost every economic recovery in recent history.

The momentum from the housing rebound during 2012 has remained strong in the early months of 2013. Our near-term outlook is for steady gains in home sales, building activity, and price appreciation.

Housing affordability remains excellent. The overhang from unsold properties is gone, and demographics are favorable.

Thank you again for joining us. Tim Sloan, our Chief Financial Officer, will now provide more details on our results this quarter. Tim?

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

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

Wells Fargo had another outstanding quarter with record earnings of $5.2 billion, up 22% from a year ago and up 2% from the fourth quarter. Earnings per share reached a record $0.92, up 23% from the first quarter last year. We have now achieved 13 consecutive quarters of earnings per share growth and eight consecutive quarters of record EPS, quite an achievement given the environment during that period.

Revenue was down this quarter, reflecting two fewer days in the quarter, a decline in equity gains from elevated levels we had in the fourth quarter, and an expected decline in mortgage volumes. We were not surprised by these declines. We had anticipated them, and we are very pleased with the strong fee growth we generated in a number of our other businesses.

Our quarterly results also reflect lower expenses, strong credit performance, and increased capital levels. As John highlighted and you can see on page 3, we had year-over-year growth in pre-tax pre-provision profit, net income, EPS, both total and core loans, deposits, and a higher ROA and ROE.

Slide 4 highlights why we have been able to generate consistently strong results -- the diversity of our revenue. We remain balanced between fee and spread income, and our sources of fee income are highly diversified.

Mortgage banking account for 26% of our fee income this quarter and was 13% of our total revenue. We could not be more pleased with the performance of our mortgage business.

What may surprise some of you is that trust and investment fees accounted for 30% of our fee income in the first quarter and has generated more fee income than any other category, including mortgage, for the past four quarters. We had strong year-over-year fee growth with a number of

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our businesses, with deposit service charges up 12%; brokerage up 12%; trust and investment up 6%; investment banking up 37%; card fees up 13%; merchant processing fees up 23%; and mortgage servicing income up 25%.

With over 80 businesses, they are not all going to grow every quarter. We are excited about the market share and cross-sell growth we achieved this quarter across a number of our businesses. The diversity of our revenue enables us to make the right long-term decisions and be disciplined in managing risk.

Overall this was a pretty straightforward quarter from a balance sheet and an income statement perspective; but let me highlight some key drivers to our results on the next two slides. On page 5 you can see we continued to have balance sheet growth this quarter, growing both loans and deposits.

Even though we purchased a total of $17.8 billion in agency MBS in the quarter, our short-term investments and Fed funds sold balances increased by $6.5 billion as average deposits continued to grow. We grew our securities available-for-sale portfolio by $13 billion, up 5.5% from the fourth quarter.

This is our largest linked-quarter increase since the fourth quarter of 2011. We took advantage of the rate back up at various times within the quarter, as rates rose and yields became more attractive.

Turning to the income statement on page 6, I have already highlighted some of the factors affecting the decline in revenue we had this quarter, and I will talk about net interest income and non-interest income drivers in a minute. Non-interest expense has declined as expected, reflecting the elimination of seasonally -- of elevated items we had last quarter and the addition of some seasonally higher benefit costs in the first quarter.

Our effective tax rate this quarter was 31.9%, which included the benefit associated with the realization for tax purposes of a previously written-down investment. We expect the full-year effective tax rate to be higher, absent additional discrete benefits.

Let me now cover our business drivers in more detail. As shown on page 7, period-end loans were up $33.5 billion or 4% from a year ago and grew by $392 million from the fourth quarter. Loan growth included the runoff of our liquidating portfolio, which declined $17.4 billion from a year ago and $3.7 billion from the fourth quarter.

Excluding these liquidating loans, our core portfolio grew by $50.9 billion or 8% from a year ago and was up $4.1 billion from the fourth quarter. Our linked-quarter loan growth was impacted by the very strong quarter-end growth we had last quarter, and the fact that we were able to retain and add to those loan balances is a real positive.

Commercial loans grew $516 million in the quarter on growth in foreign loans. We saw declines in foreign loans throughout most of last year, and the growth we achieved this quarter was in trade finance, reflecting increased economic activity in Asia.

Consumer loans declined $124 million, with growth in first mortgage and auto offset by declines in junior lien mortgages and expected seasonal declines in credit card and student lending. The growth in first mortgage loans benefited from the retention of $3.4 billion of new conforming fixed-rate production. We currently do not plan to retain additional first mortgage production, although we have the flexibility to do so if conditions change.

We continued to grow deposits in the first quarter, with period-end deposits up $7.9 billion from the fourth quarter. Average deposits were up $71.2 billion or 8% from a year ago, and up $10.1 billion from the fourth quarter.

We also grew our primary consumer checking account customers by a net 2.1% from a year ago. These are basically active customers who transact with us regularly.

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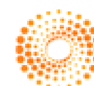

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We continued to lower our deposit costs, with average deposit costs of 15 basis points in the first quarter, down 1 basis point from the fourth quarter and down 5 basis points from a year ago. We have successfully grown deposits while reducing our deposit costs for nine consecutive quarters. Our ability to lower deposit costs while consistently growing deposits reflects our long-standing relationship focus and pricing discipline.

As shown on page 9, tax-equivalent net interest income was down 2% from the fourth quarter, primarily due to two fewer days in the first quarter. Without this day count impact, net interest income would have been essentially flat.

Average earning assets grew $21.6 billion from the fourth quarter, reflecting increases in short-term investments, loans, and available-for-sale securities. Our net interest margin declined by 8 basis points from the fourth quarter to 3.48%. This decline was driven by three primary factors.

First, our continued deposit growth caused cash and short-term investments to increase, reducing the margin by 3 basis points. As we've highlighted in the past, our deposit growth is obviously beneficial to deepening customer relationships and does not negatively impact net interest income, but it is dilutive to the NIM.

Second, 3 basis points of the decline was due to lower variable income, including PCI loan resolutions and periodic dividends. Finally, 2 basis points of the margin pressure was driven by the ongoing repricing of the balance sheet in this low rate environment, net of the growth in loans and AFS securities. Growing net interest income remains our focus, which we believe we can grow even in this low rate environment.

Non-interest income was down from the fourth quarter on lower gains on equity investments, which were highlighted last quarter as being above average, and the expected decline in mortgage which I will highlight in the next slide. Because of the seasonality of many of our businesses and the lower day count in the first quarter, it is best to look at the year-over-year growth rates to demonstrate the momentum we have had in many of our businesses.

Deposit service charges increased 12%, reflecting customer growth and product and pricing changes. Brokerage fees and trust and investment management fees grew, reflecting strong net asset flows and higher equity valuations. Investment banking fees were up 37% from a year ago as we continue to do more business with our Wholesale customers. Card fees were up 13% with growth driven by strong new account growth and higher credit and debit card spend.

On page 11 we highlight some mortgage trends. While mortgage revenue was down this quarter, as expected, we still had strong originations of $109 billion, our sixth consecutive quarter of more than $100 billion in originations. Mortgage revenue was reduced by $112 million this quarter from the retention of $3.4 billion of conforming first mortgages.

Gain on sale margins remained historically high; and as we have been saying for the past few quarters, we would expect these margins to decline. Origination volume for the rest of the year will obviously depend on continued strength in the housing market and interest rates; but we expect volumes to remain relatively strong, given the improved purchase market and the benefit of the spring buying season.

In fact, we have already seen the improved purchase market benefiting our results, with originations for home purchases up 31% this quarter compared with the year ago. And also many of our existing customers can still benefit from a refinance.

We added $309 million to our repurchase reserve this quarter, down $70 million from the fourth quarter. Our repurchase reserve balance increased to $2.3 billion. Our repurchase reserve incorporates current demand levels, considers all vintages, and anticipates probable future expected demands.

Our servicing portfolio continued to perform better than the industry. Our total delinquency and foreclosure rate was 6.54% in the first quarter, down 50 basis points linked-quarter and down from 6.89% a year ago.

Turning to expenses on page 12, first-quarter expenses declined $496 million from the fourth quarter which had included higher operating losses and a contribution to our Foundation. As expected, our first-quarter expenses included $460 million of seasonally higher employee benefit expenses from higher payroll taxes and 401(k) matching, as well as $199 million in annual equity awards for retirement-eligible team members.

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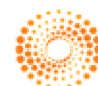

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In addition to lower operating losses and charitable contributions, we reduced expenses in a number of other areas including occupancy, outside professional services, contract services, and advertising and promotion. We expect expenses to be lower in the second quarter, reflecting lower employee benefit expenses that were seasonally higher this quarter. But there will be normal growth in other areas including ongoing investments in our business and normal merit increases.

Our expense efficiency ratio of 58.3% was within our target range of 55% to 59% and was down 180 basis points from a year ago. We have been focused on reducing expenses for years, as you can see the impact on our results. But we still believe our expenses are too high and we can continue to improve our efficiency ratio.

Last quarter we highlighted environmentally elevated cost, and we have made progress in reducing these costs this quarter as shown on slide 13, and we expect them to continue to decline. We had approximately $50 million of continued costs from the Independent Foreclosure Review this quarter, and these costs will be fully eliminated next quarter.

Foreclosed asset expense was down $26 million from the fourth quarter and down $109 million from a year ago, reflecting the improvement in the housing market which we expect will continue. Mortgage revenue this quarter was reduced by $250 million for additions to our repurchase reserve not related to current originations, and was reduced by $58 million to reflect higher servicing and foreclosure cost as some foreclosure timelines continue to extend.

Turning to our segment results, starting on page 14. Community Banking earned $2.9 billion in the first quarter, up 25% from a year ago and up 2% from the fourth quarter.

Retail Banking achieved a record cross-sell of 6.1 products per household up from 5.98 a year ago. To better meet our customers' financial needs and improve cross-sell, we continually invest in our business, including new store designs, improved technology, and adding bankers. We grew platform banker FTE by 1,528 from a year ago and by 478 in just the first quarter alone.

Our credit card business continued to have strong account growth, with a record of 577,000 new accounts in the first quarter, up 18% from a year ago and up 31% from the fourth quarter. Our household penetration increased to 34.1%, up from 29.9% a year ago. Credit card balances are down from the fourth quarter, reflecting normal seasonality, but are up 10% from a year ago, reflecting strong account growth.

We also had continuing momentum in our auto business, and we are now the industry's leading auto lender. We generated record auto originations in the first quarter of $6.8 billion, up 10% from a year ago and up 27% from the fourth quarter. We also successfully met the needs of our small-business customers, with business checking accounts up 2.9% from a year ago. We also extended $4.2 billion of net new loan commitments to small-business customers this quarter, up 24% from a year ago.

Wholesale Banking earned record net income of $2 billion in the first quarter, up 9% from a year ago and up 1% from the fourth quarter. Wholesale Banking results continued to benefit from steady loan growth, with loans having grown for 10 consecutive quarters.

Industry loan growth remains tepid, but our relationship focus has enabled us to grow market share, and we have been able to generate middle-market loan growth for 11 consecutive quarters. This growth has occurred as we maintained our pricing and risk discipline.

Our risk and underwriting discipline is also reflected in the $8 million in loan-loss recoveries in Wholesale Banking this quarter. The last time Wholesale was in a net recovery position was nearly seven years ago in the second quarter of 2006.

Asset Management fees were up 8% from a year ago and were up 2% from the fourth quarter. Total assets in a management increased $11.4 billion from the fourth quarter, with growth in all asset types. The growth reflects the benefit from favorable markets and $4.1 billion of net inflows in the first quarter. Wholesale Banking's continued focus on building relationships (technical difficulty) resulted in cross-sell of 6.8 products per relationship, up from 6.6 a year ago.

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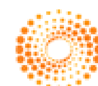

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Wealth, Brokerage and Retirement earned $337 million, up 14% from a year ago, driven by strong growth in asset-based fees and higher brokerage transaction revenue. Earnings were down 4% from the fourth quarter, reflecting seasonally higher personnel expenses and lower net interest income.

Wealth, Brokerage and Retirement has continued to successfully grow client assets, benefiting from improved markets and growing market share. WBR client assets reached a record $1.5 trillion, up 7% from a year ago, including strong growth in Retail Brokerage managed account assets, up $46 billion or 16%, driven by strong net flows and market performance, as well as growth in average core deposits, up 10% to $149 billion.

The growth in managed account assets in the first quarter will benefit our revenue from advisory fees next quarter, since they are priced on a quarterly lag. In addition, WBR continued to effectively partner with Retail Banking to meet all the financial needs of our customers, increasing cross-sell to 10.33 products per household, up from 10.16 a year ago.

Turning to credit quality on page 17, we had significant improvement across our commercial and consumer portfolios. First-quarter net charge-offs declined to 72 basis points of average loans, the lowest level since the second quarter of 2006.

Losses in our commercial portfolio were only $90 million, or 10 basis points of average loans. Obviously, this is very strong performance; and we would expect commercial losses to remain low, but probably fluctuate around these levels.

Consumer losses declined to 123 basis points with strong improvement in our real estate secured portfolios. These portfolios should continue to benefit from our underwriting discipline and the continued improvement in the housing market.

Reflecting this improved credit performance, we released $200 million in loan loss reserves in the first quarter. Absent a significant deterioration in the economy, we continue to expect future reserve releases in 2013.

Nonperforming assets decreased $1.6 billion from the fourth quarter and were down $3.8 billion or 14% from a year ago, with declines in both non-accrual loans and foreclosed assets. Loans 90 days or more past-due decreased $75 million from the fourth quarter and were down 17% from a year ago, with improvement in both commercial and consumer loans. Early-stage consumer loan delinquency balances and rates also declined significantly from the fourth quarter and a year ago, with balances down 19% and with improvements in every portfolio on a linked-quarter basis.

As shown on page 19 our capital levels continue to grow. Our Tier 1 common equity ratio grew to 10.38%, up 26 basis points from the last quarter. The ratio this quarter was negatively impacted by 25 basis points from the implementation of Basel 2.5, which became effective on January 1. This implementation was reflected in our 2013 CCAR plan and did not impact our ratio under Basel III, as its impact has historically been included in this calculation. Our estimated Tier 1 common equity ratio under Basel III capital proposals increased to 8.39% in the first quarter.

We purchased 16.6 million shares, but issued 39 million shares in the first quarter, which was seasonally high because of employee benefit plan issuances. Our 2013 Capital Plan included an increase in common stock repurchases compared with our 2012 repurchases.

Our Capital Plan also included a $0.30 per share second-quarter dividend, which we will recommend to our Board at our meeting this month. This would be an increase of 36% over the second-quarter dividend last year and a 20% increase over our first-quarter dividend this year, which we had increased to $0.25 a share.

Our diversified model provides us with many opportunities to grow earnings, as highlighted by in our 13 consecutive quarters of EPS growth. On slide 20 we summarize some of the momentum we have realized throughout our businesses that I have highlighted on the call. The market share gains, customer growth, increases in loans, deposits, assets under management, positions us very well for 2013.

We also have the opportunity to further reduce expenses, benefit from improvement in credit, and deploy liquidity prudently to meet loan demand or to invest. In addition, we believe that the housing market will continue to improve, which will not only increase economic growth for our country but should benefit our revenues, reduce environmentally elevated expenses, and lower losses in our real estate secured portfolios.

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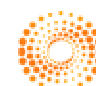

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In summary, we had exceptional results this quarter, earning more than we have ever earned in the history of Wells Fargo. Our EPS grew by 23% from a year ago, and we reduced expenses by 5%. Pre-tax pre-provision profit increased 2% and credit continued to show significant improvement, with losses down 41% and total chargeoffs declining to 72 basis points.

ROA grew to 1.49%, within our targeted range of 1.3% to 1.6%. And ROE increased to 13.59%, also within our targeted range of 12% to 15%. We continued to grow our capital levels while returning more capital to our shareholders by increasing our dividend and continuing to buy back our shares.

We will now open up the call for questions.

QUESTIONS AND ANSWERS

Operator

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

Erika Penala - *Bank of America Merrill Lynch - Analyst*

Good morning. My first question, John, is on your capital priority. It is clear that a dividend is on top of the list, and your yield is clearly best in class. However, I wonder how you think about weighing your buyback opportunities versus strategic opportunities for acquisition.

Because on one hand most of your shareholders are clamoring for more buyback and to actually see shares outstanding -- the count reduced. But on the other you have -- you are not a lot of banks that have your currency. So I guess if you could give us an insight in how you are thinking and weighing these issues.

And additionally. does the trajectory of mortgage have anything to do with favoring one strategy over the other?

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

Sure. Thank you for the question. We have stated publicly, and I know you know this, that our payout ratio we have targeted 50% to 65%. I believe the first call in capital is to grow the business; and we have ample capital to do that and meet those payout targets.

With respect to M&A, remember that the biggest users of capital on an M&A side would be on the deposit side of the franchise, of which of course we are at our federal statutory number or close to it. And the acquisitions that we have talked about being interested in would be mostly bolt-on businesses to our existing portfolio suite, of the kind of 80 different businesses we do here, and predominantly in the United States.

So we have done some portfolios in the past. We are still interested in things around Wealth, Brokerage and Retirement. But I don't see that as a huge draw on our capital.

This Company is uniquely positioned that we are producing terrific returns in absolute terms and in relative terms. There is plenty of liquidity and performance there to meet a number of goals. Again, investing in our business; doing strategic, bolt-ons where they make sense; and returning capital to our shareholders at the kind of levels we have talked about.

Erika Penala - *Bank of America Merrill Lynch - Analyst*

Got it. My follow-up question was for Tim. Speaking of liquidity, I have already gotten a few questions in my inbox regarding how high your liquidity levels remain.

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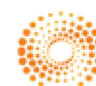

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I guess, could you give -- obviously deposit growth continues to be strong. But could you give us a sense in terms of why you are keeping it at this high of a ratio relative to your earning assets?

Is it you are afraid of the duration risk? Is it -- speaks to a question mark on the duration of deposit flows? Or is it as John alluded to, warehousing some cash in order to take advantage of some of the bolt-on opportunities that could be out there?

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

Yes, Erika, that is a really good question, because our liquidity levels are low. We view that as a real positive for the Company. Clearly the first call on our liquidity is always going to be for our customers.

And we have seen good loan growth year-over-year; our core loans are up $50 billion. But even with that, as you point out, we have seen very strong deposit growth.

We did deploy some of that liquidity that wasn't needed for loan growth in the first quarter at a slightly higher rate than what we have seen in the last year, when we saw rates back up. As you recall, we saw rates back up toward the end of the fourth quarter and we purchased some securities. They dipped back down; and then they backed up again throughout the quarter. And we purchased $17.8 billion of MBS.

Our plan continues to be to make the right long-term decisions and the right risk-adjusted decisions in terms of how we deploy our excess liquidity. We don't want to significantly increase duration.

So our liquidity is up. We view that as a positive, and we are looking forward to deploying it in the future.

Erika Penala - *Bank of America Merrill Lynch - Analyst*

Okay. I will step aside. Thank you.

Operator

Joe Morford, RBC Capital Markets.

Joe Morford - *RBC Capital Markets - Analyst*

Thanks. Good morning, guys. Now that you are starting to see a more sustained slowdown in mortgage applications, pipeline, and originations, how are you thinking about the headcount in this division? And have you begun to address some of the variable costs there?

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

Well, we actually added to the number of team members in the mortgage business in the fourth quarter, because we wanted to improve the customer service in the business. And you saw -- and we have seen a reduction in the time from app to close go from about 90 days to 60 days, which we view is a real positive and a competitive advantage.

The mortgage business is still very strong. At $109 billion it, as we mentioned, is our sixth consecutive quarter of originations above $100 billion. And we started this quarter with a fairly strong pipeline at $74 billion on an absolute basis and relative to almost most quarters we have ever been in business.

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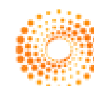

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So the business continues to be strong. And as I mentioned we also saw an increase in purchase activity in the first quarter, up 31% year-over-year. I think the other positives in the business are we have now seen an extension of the HARP program; and with rates rallying again we have got more customers that could take advantage of a refinance. As well as the fact that as housing values go up there would be more customers that could potentially take advantage of a refinance.

So I think we are very bullish on the business. That said, our expectation is that it is probably likely that revenues and margins will come down a little bit.

All that said, to the extent that it comes down further than we think, we will adjust cost as our team has done through various cycles on a number of occasions. So that may happen this quarter; it may not. I kind of hope it doesn't happen because it means revenues will continue to be growing, so that would be nice.

Joe Morford - *RBC Capital Markets - Analyst*

Right. I guess along those lines, too, what about other opportunities to sustain origination volumes? Just given some of the capacity issues you've had in recent quarters and maybe perhaps more proactively marketing to tap into some of this pent-up demand.

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

Well, Joe, I think that is a really good point. The way that our team thinks about it, and one of the reasons we want to make sure that we are adequately staffed, is that we do view the purchase market as a big opportunity. So that as refinancing volume comes down, which it has come down over the last few quarters, we have our sales folks out there and our bankers out there being more proactive with our customers.

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

That's a great point, Tim. Joe, this really plays to our strength, our One Wells Fargo working as a team. We have 30,000-plus bankers in our stores. Not every one of our customers who call us their bank has their mortgage with us. And we have kept our relationships with our realtor friends and our builder friends during the big refi time. and this is really where it comes -- it really pays off.

As in Tim's comments he mentioned that purchase volume is up 31% year over year. So that is really important for us.

Joe Morford - *RBC Capital Markets - Analyst*

Okay. Thanks so much.

Operator

John McDonald, Sanford Bernstein.

John McDonald - *Sanford C. Bernstein & Co. - Analyst*

Hi, good morning. I was wondering if you could elaborate a little bit, Tim, on the factors that helped keep the mortgage gain on sale flat at very healthy levels this quarter; and what will be the puts and takes on that going forward; and if you have any outlook there.

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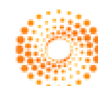

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Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Yes, good question, John, because at 2.56% it is historically high and really right on top of what we saw in the fourth quarter. Recall that our accounting convention is to recognize most of the gain on sale when we book the loan; and so the primary/secondary spread changes in the quarter and rate movements was really beneficial.

I think in terms of outlook, let me throw some numbers at you and then you can conclude what you think the right gain on sale margin might be. If you look over the last four years, and I am going to use yearly averages, the highest average we had was not surprisingly in 2012, which was 2.3%. The lowest average that we had, which was in 2011, was 1.61%.

So when you step back and look at 2.56% I think it is reasonable, as we said in the fourth quarter, to assume that the gain on sale is going to come down. My guess is it will probably end up somewhere in the range of between 1.61% and 2.33%; but I don't know exactly where it's going to be within that range.

John McDonald - *Sanford C. Bernstein & Co. - Analyst*

Okay. In terms of the mortgage putbacks, at what point will you know it is okay to start using some of that reserve? With credit we can see when the inflows slow and you start to see chargeoffs come down and forward-looking. On the putback front, when do you start maybe consuming or stop needing to add to that reserve?

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

Well, John, I hope it is sooner rather than later. I don't know for sure. But when we think about our mortgage repurchase reserve we not only look at what the current demands are but also what expected demands are.

So it has come down now for the last three or four quarters, which we are pleased with. But we just haven't seen that yet. We need to be very comfortable that not only current demands but also future expected demands are going to come down. So hopefully it will be in the next few quarters.

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

John, an improving housing market sure is a good sign regarding that issue. It's not the only thing that influences it, but that is good news.

John McDonald - *Sanford C. Bernstein & Co. - Analyst*

Tim, one quick follow-up on the share count issue. We know that you know that shareholders are hoping to see the share count come down, and it hasn't yet. We know in 2013 your plan involves more buybacks.

So I guess the question is, does it also involve more issuance? Or do you hope to have the same issuance issue that you did last year, such that your net share count would come down this year given that you are doing more buybacks?

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

Right. So, John, I certainly appreciate that share count is a big focus. Candidly, earnings per share is a bigger focus for us. We have been pleased to be able to grow that for the last 13 quarters.

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I think that when you think about the fact that last year we repurchased 120 million shares the likelihood -- again, this is a function of our share price that we repurchase shares at -- the likelihood is that we will probably repurchase more shares than we did last year and probably repurchase more shares than we issue. And we will know in a year.

John McDonald - *Sanford C. Bernstein & Co. - Analyst*

Right.

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

But again, our primary focus is going to be growing earnings per share. But make no mistake; our Capital Plan calls for an increase in total share repurchase dollars versus what we did last year, and we are going to be repurchasing our shares at a greater rate this year than last.

John McDonald - *Sanford C. Bernstein & Co. - Analyst*

Okay. One quick follow-up on something you said in January. I think you said that in January you hoped to grow net interest income dollars. Even though it is a tough environment and you've got some pressure on spreads and things like that, you're focused on the net interest income dollars, and you are having some earning asset growth.

Do you still -- I know in the first quarter you had day count pressuring the NII dollars. But do you still hope to grow that in 2013?

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

Yes, we did. I think that when you look at net interest income we could have had the same conversation a year ago and had the same concerns, and they would have been absolutely valid. But last year we were able to grow our net interest income by over $0.5 billion; and our expectation is that we should be able to grow it this year.

Again, it is harder to see this quarter because of the two fewer days. But if you step back and look at the last three quarters, you can see that notwithstanding the decline in net interest margin, that the net interest income has more or less bottomed at about $10.6 billion.

John McDonald - *Sanford C. Bernstein & Co. - Analyst*

Got it. Okay. Thanks, Tim.

Operator

Matt O'Connor, Deutsche Bank.

Matt O'Connor - *Deutsche Bank - Analyst*

Good morning. Just following up on the net interest income dollar question. As you think about the relationship of balance sheet growth and the NIM percent, do we get an acceleration in the balance sheet growth, or do we get less NIM pressure to drive those dollars higher? How would you envision that playing out?

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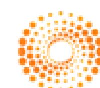

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Tim Sloan - *Wells Fargo & Company - Senior EVP, CFO*

Well, recall that the primary driver for the decline in the net interest margin over -- just look over the last three years, 12 quarters. The decline has been 79 basis points. Almost three-quarters of that decline has been driven by the fact that deposits are growing.

Again, we view that as a very positive sign for the long-term growth of the Company. When you pull that out, that net differential is really the decline in overall margins. So my bet is that if we see further net interest margin decline it is probably more likely going to be driven by deposit growth than by margins.

But there is no question that the net interest margin in this interest rate environment, as the balance sheet reprices, continues to be under pressure. But again let me emphasize, we believe that we can grow net interest income just like we did last year, year-over-year, even in this environment.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay. Then separately, the charge-offs came down sharply; and you commented both on the commercial piece and broadly speaking on the consumer. Is the level that we are at on the real estate related areas in the consumer, is this kind of a -- I don't want to say normal -- is this a clean level? Or did some of the upfronting of charge-offs in the second half of last year related to regulatory changes, did that impact these numbers at all?

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

No; and I wouldn't describe it as upfronting. Clearly there was some OCC guidance that we had for a portion of the portfolio that we needed to address -- and others in the industry address this.

I would view this as the chargeoff level and the credit performance has just been terrific. And I don't believe that this is the bottom in terms of consumer loan losses.

Again, the commercial losses are a little bit different story. At 10 basis points it doesn't take a lot of change to increase those or even decrease them a little bit.

But in terms of consumer loan losses at 123 basis points, our guess is that -- assuming the economy continues to improve and assuming that we are going to continue to see an improvement in the residential housing market, which we both -- we think is going to happen -- we should continue to see a decline.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay. Then just a last clarification. You talked about the tax rate bouncing up a little bit. Any -- what number should we be using for the rest of the year?

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

Well, I don't know what the number is going to be. We just wanted to make sure that you all didn't use the tax rate in the first quarter and then just annualize it. I think it will be closer to more historical levels that we have seen in other quarters or other years where we haven't had some tax benefit like we had in the fourth quarter.

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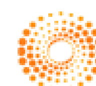

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Matt O'Connor - *Deutsche Bank - Analyst*

Okay. So maybe 32% to 33% if I look at the last few years?

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

Yes, that's not -- that is a reasonable range, Matt.

Matt O'Connor - *Deutsche Bank - Analyst*

Okay. Thank you very much.

Operator

Moshe Orenbuch, Credit Suisse.

Moshe Orenbuch - *Credit Suisse - Analyst*

Great, thanks. You alluded to purchase mortgage market stepping up. But isn't the scale tough just given how much of your originations are refis right now? I mean, how so you -- I mean, I guess if we look at let's say projections for the industry, how should we think about your market share and what that would mean for originations for the balance of the year?

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

Well, Moshe, I think you make a very fair point; and we didn't mean by pointing out that purchase money activity was up 31% year-over-year, that that in and of itself is going to take the place of the decline in refinance volume. Because as we have said and you have seen in our numbers that our total mortgage volumes are coming down. I think what we are seeing is that they are not coming down maybe as fast as some folks might have thought, because of the improvement in the purchase money market.

Moshe Orenbuch - *Credit Suisse - Analyst*

Got it.

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

I think it is also factual that when you look at the market share that we have in the refinance market, it is higher because of the size of our servicing portfolio than it would be in the purchase money market. But again that is why we want to make sure we have more folks in the business being proactive with our customers, so that we can grow our purchase money activity.

John, I don't know if you want to comment.

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

The way we think about this -- we think this is a really important consumer product, and we have made investments in this business and have performed through a variety of cycles. We happen to think now, yes, no question, that there will be less refinancing. A lot of people have done their refinancing.

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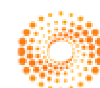

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But even in that area the average rate in our servicing portfolio is just shy of 4.7%. The street rate is given, depending on the day, 100 basis points less than that. So there is still refinance volume.

But on the purchase money side we are going into the stronger selling season now. We have over 6,000 banking stores with bankers who are dealing with customers every day. We have 10,000-plus home mortgage consultants out with their relationships.

And we will get our share -- hopefully plus some. And if it is not there, we can adjust quickly because we have the experience, to bring our costs down and reflect that.

But remember, housing is improving every day. More people have more equity in their homes. Americans have not lost their emotional attachment to homeownership.

And it can't be for everyone, but we want to be there to help as many customers as we possibly can. We like this business a lot.

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

Moshe, let me just give you a couple other numbers to put it in perspective. A year ago, our pipeline starting the second quarter was $79 billion; and now we're at $74 billion. And 35% of that $74 billion pipeline is purchase money activity. That is an increase from about 24% a year ago.

So it is having some impact, which we are very excited about.

Moshe Orenbuch - *Credit Suisse - Analyst*

Perfect, thanks.

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

In the overall market -- the overall purchase -- still it is low. I mean by historical standards. So normal market is a pretty good market for us.

Moshe Orenbuch - *Credit Suisse - Analyst*

Yes, two quick follow-ups. One is your correspondent share fell this quarter. And JPMorgan reported today, they are the number two player; theirs went up.

Could you talk about what your thought process is? And maybe related to the issue of whether you are thinking about selling either actual MSRs or a (technical difficulty) servicing strip, if that asset were to increase from here?

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

Yes, the decline in share in the correspondent business -- there wasn't anything in particular going on. I think it is just a very competitive market.

But as it relates to the MSR you probably saw this week that we did sell some reverse mortgage MSR. That really -- I wouldn't describe that as a strategic change in terms of our thought about the overall MSR. That just reflects the fact that we got out of that business, originating those loans, a couple of years ago; and we thought it was prudent to continue to reduce our servicing activity in that business.

There has really been no change in our view of the MSR. It is still an important asset for the Company. From time to time we may decide to sell, but again I wouldn't read too much into the sale of the reverse mortgage MSR.

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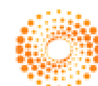

Moshe Orenbuch - *Credit Suisse - Analyst*

Thank you.

Operator

Paul Miller, FBR Capital Markets.

Paul Miller - *FBR Capital Markets - Analyst*

Yes, how are you guys doing? I don't want to keep on harping on the mortgage; but we saw yesterday that HARP got extended for two years. I think you guys have said publicly that you think the bulk of your HARP has already been -- you already originate or refinance a bulk of your HARP.

Do you think that if there is a good, solid PR program from the White House to get people off the sidelines, do you think that would -- and (technical difficulty) two-year extension, do you think you could see another wave of HARP mortgages being done?

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

Yet, I don't know if it will be another wave. Our HARP originations in the first quarter were 10%, which was down from the mid-teens that we saw last year. I think this is a positive.

The HARP program has been a very successful program. I think the numbers nationwide are over 2.2 million homeowners have been able to refinance via HARP; so it has been a successful program. I don't think it will be a new wave, but continuation is very good.

Paul Miller - *FBR Capital Markets - Analyst*

Then a follow-up on the securities portfolio. Was that just being optimistic on the rates going up, because you feel rates are going to remain relatively flat? Or is this something when we see rates go up we could see the portfolio grow in that category?

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

I think if we see rates go up from here you could see us being as active as we were in the first quarter. We had a fairly -- on a percentage basis and also absolute levels -- pretty sizable backup in the first quarter. If you recall there were some days when the 10-year was above 2.20% and MBS was very attractive.

And from our perspective, given the amount of liquidity that we have and given that we want to maintain a pretty steady duration and we don't want to take excessive credit risk, it just makes sense to take advantage of those opportunities. We are not going to deploy all of it in one day; but again, given our liquidity, to be able to deploy $17.8 billion in the quarter on an opportunistic basis was very good from our perspective.

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

You know, Paul, as Tim mentioned, I think in his comments, this is really, we think, a strength for the Company, to have the kind of liquidity available. We may make risk-return decisions every day, and when we think it is favorable and in our shareholders' interest we will deploy that. And if we don't think the right risk-return ratio is there we are willing to pass, and we don't have to do something. But this is a source of strength.

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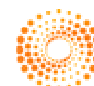

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Paul Miller - *FBR Capital Markets - Analyst*

Does it surprise you guys a little bit, because I know it does me, where we are seeing the housing market start to pick up, we are seeing homebuilders building homes, but there is still really not a lot of loan growth being created. Do you see that changing over the next couple quarters?

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

You mean loan growth for homebuilders or for consumers?

Paul Miller - *FBR Capital Markets - Analyst*

No, just for overall economy. That is one of the areas of activity we are seeing, but it doesn't seem like to be materializing in the overall economy.

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

Well, I wouldn't jump to any conclusions about loan growth in the industry in the first quarter. If you look at the HA data, for the last few years the first quarter tends to be a seasonally low quarter.

What I would do it -- and again this is just me -- I would take the first-quarter decline for the industry and also then add to that the fourth quarter -- that we saw last quarter -- increase; and probably average those together. Remember the fourth quarter of last year was extremely high because of some of the changes and decisions that folks were making because of the potential changes in taxes and the code and so on.

So again I think what we are seeing in the industry is steady loan growth if you average over the last few years at about 1-ish-% on a quarterly basis. We have been fortunate because we have been able to grow at a multiple of that.

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

If you look, Paul, at some of the drivers -- if you look at household formation, if you look at cost of financing, cost of housing, there is a lot of tailwinds, a lot of favorable attributes. Now, nobody can predict what is going to happen. But if anything today there is probably a shortage of housing on the market.

Paul Miller - *FBR Capital Markets - Analyst*

Guys, thank you very much.

Operator

Betsy Graseck, Morgan Stanley.

Betsy Graseck - *Morgan Stanley - Analyst*

Hi, good morning. Just on your last comment, shortage of housing in the market, that is a pretty powerful statement. Is there any specific geographies you are seeing that in?

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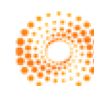

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John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

You know, it is not true in every market and in every price range. But when I'm out talking with realtors and customers the amount of supply, especially in the lower end or starter houses, there is not a lot of supply out there.

Betsy Graseck - *Morgan Stanley - Analyst*

Okay.

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

Go ahead. No, I have nothing.

Betsy Graseck. All right, so then obviously that has some powerful implications for your business model over the next year or so, as long as we keep rates low. And I guess that is kind of my question. Do you feel like part of this housing improvement that we are seeing is a function of where rates are? Clearly at 3.7%, 3.3%, in that range that has got to be fueling part of the boom here.

To what degree are you building your business based on the current interest rate environment? To what extent -- how do you protect yourself for the Fed deciding to stop QE3?

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

Yes, Betsy, I would say the housing market is as much driven by confidence and by about improvements in values as it is with rates. I don't know of many people who are on the sidelines and say -- I will only buy a house if the rate is 3.25%, and I won't buy at 4.25%. I think it is about jobs, about confidence, about feeling good about where things are going.

Surely rate is -- when you buy a house it is what you make, what the house costs, and what your financing costs are -- the big three. But housing is improving at different levels, but virtually everywhere that we see in the country.

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

And then, Betsy, the second part of your question, which is related just to the interest rate risk and how do we protect ourselves, we are actually positioned very well over the medium and longer term to benefit from an increase in interest rates again, as long as it is not such a large increase that it negatively affects economic growth.

But we are positioned very well. And it is one of the reasons why we continue to maintain the level of liquidity that we have.

Betsy Graseck - *Morgan Stanley - Analyst*

Great. Can I just follow up on one other thing?

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

Sure.

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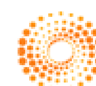

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Betsy Graseck - *Morgan Stanley - Analyst*

I think you mentioned earlier on that you are not planning on retaining any more of the conventional production as you have over the last couple of quarters. I guess I am just wondering how you get to that decision.

Gain on sale coming down over the next couple of quarters, I would think it would tip in favor of retaining versus securitizing. But I am sure you are thinking of a broader range of inputs than that. Maybe you can help us understand your logic.

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

Sure. That's a good question. Recall that the primary driver for the reason why we wanted to hold some of our first mortgage production in the third and the fourth quarters of last year was because interest rates and investment alternatives, given the level of liquidity, were just very unattractive from our perspective. If you think about where rates were in almost all categories in the third quarter and the fourth quarter last year -- that is the primary driver, not necessarily the gain on sale margin.

So as we looked at the first quarter -- and we mentioned this last quarter -- we saw the opportunity to invest because rates seemed like they were backing up and we took advantage of that rather than hold our first mortgage production. So that is going to be the driver. It is investment alternatives, not gain on sale margins.

Betsy Graseck - *Morgan Stanley - Analyst*

Okay, thanks.

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

But certainly if, for whatever reason, rates would really rally from here and we could see a repeat of the third and the fourth quarter, we would reconsider holding some of the mortgages. Again that remains an option and that is another strength to the business model.

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

Correct. We don't preclude that.

Betsy Graseck - *Morgan Stanley - Analyst*

Right, okay. Yes. Because you did get a backup obviously in rates and now rates have come back in. So you will be nimble is basically what you are saying.

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

Correct. Nimble as we can be.

Betsy Graseck - *Morgan Stanley - Analyst*

Thanks.

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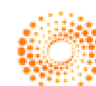

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Operator

Mike Mayo, CLSA.

Mike Mayo - *Credit Agricole Securities - Analyst*

Hi, back to net interest income, and you said that is a focus. But at least linked quarter it stunk. I know the day count, and you seem pretty confident that $10.6 billion is a bottom.

I am just trying to figure out what would make you so confident. Would it be anything to do with the accretable yield going forward, given better credit quality? The balance sheet repricing, maybe you only hurt 2 basis points, you feel better there?

Or is it really just you added all these securities opportunistically and that will play out for a full quarter; and we should see that in the second quarter?

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

Well, Mike, I am always careful not to disagree with you, but I wouldn't say that $10.4 billion of net interest income stunk. I mean it was down; but if you just added two extra days -- and that is an issue with the calendar -- it would have been $10.6 billion. We actually think in the environment when you look at the entire industry, that that was very good performance.

But having said that, I think that the answer to your second question is it is all of the above. We have consistently been able to grow our loans at a multiple of what the market is growing. That is number one.

Number two, we are going to continue to take advantage and redeploy or deploy our liquidity when we see rates back up like we did in the first quarter and we bought $17.8 billion worth of securities.

So again, we could've had the same conversation -- and I think we actually did about a year ago -- when we looked at where rates were and where loan growth was. We were coming -- the industry was coming off a season low, just like it was this quarter. And so our perspective is that we can continue; we can grow net interest income; and in the next quarter we will see if we were able to do it. But that is our goal.

Mike Mayo - *Credit Agricole Securities - Analyst*

And of the benefit -- of the securities that you put on, was that mostly the latter part of the quarter or the early part? In other words, do we actually see it in the numbers yet?

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

Yes, that's a good question, Mike. Recall that when we talked about our first-quarter earnings we gave some specific guidance that we had purchased some MBS at the end of December when rates backed up a fair amount. And then you saw a rally again; they backed up again in early January, and we were purchasers.

Then they kind of went back and forth a bit, and then we saw a nice backup about a month or so ago and so we were pretty active. Which is why the average was less than what the total purchases were. So you are going to see more of the benefit of those purchases as we go through this quarter.

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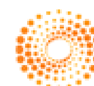

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Mike Mayo - *Credit Agricole Securities - Analyst*

Got it. Then the second question relates to the efficiency target. You are on the upper end of your target range. There is the article today talking about your new mini-branches, and I know you have talked about that in the past. Now it seems like the execution phase.

Can you just give some sense of how many of your 6,000 branches might go to this mini form, if it is correct that they cost half as much? And any other color you can give.

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

Sure. In fact, Mike, I was in Washington this last week and went by and actually toured our first neighborhood store. You would think it was a branch. It was a terrific combination of using technology and convenience both for hours and after hours. So it really is a dual purpose that way.

Our view around distribution is that it is more of a distribution community where you have stores in ATMs and online and mobile and phones all working together. And that is part of the magic of how we deepen cross-sell and how we build customer loyalty.

We don't have a plan per se that says so many of the neighborhood versus so many of traditional. But they all work. Because even our Millennial customers who are much more skewed towards self-service and mobile devices still want and need stores. And in some places you can't get a 3,000 or 4,000 square foot space, where 1,000 square feet works just as well, in fact better.

So look for us to do more. It is a test and learn kind of mode, and it is going to help us grow and deepen relationships.

Mike Mayo - *Credit Agricole Securities - Analyst*

All right, thank you.

Operator

Marty Mosby, Guggenheim.

Marty Mosby - *Guggenheim Securities - Analyst*

Hey, question focuses on the operating expenses. You have talked about the seasonal impact. If I add those up it is about $750 million in that number related to the seasonal uptick in first quarter. That starts to roll out as you move to the next quarter.

But you've mentioned the merit increase. I didn't know how much, if you can just give us some proportion of the $750 million that might get used up in the merit increase as you go to the second quarter.

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

Oh, it could be a few hundred million dollars, Marty. I think that -- I wouldn't take that $750 million and just deduct it and say that is what is going to be the second quarter.

We are going to have an impact from merit. I think we're also going to continue to invest in both people as well as technology and products. So we want to continue to grow the franchise, so I wouldn't just deduct that and call that our expenses for the second quarter.

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Marty Mosby - *Guggenheim Securities - Analyst*

Then when you look at the net charge-off rate dropping as significantly as it did, our provision number that you came through with was pretty consistent with what we were expecting. But the composition was so different in a sense of net charge-offs being lower and release of or recapture of loan-loss allowance being a lot less.

Did the lower net charge-offs and improvement in non-performers eventually start bleeding through in the recapture? Or how do you see that playing out in the sense of the magnitude going forward?

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

Well, I think you make a fair point; and that is one of the reasons why we reiterated that we do expect in the future to continue to see reserve releases, absent some big deterioration in the economy. So our expectation is that we will see more releases, Marty.

Again, it is going to be a function of the improvement in credit; and we have seen that now consistently. I think one of the important things to remember is that our reserve release is a relatively small part of our total earnings. I think it is less than 5% this quarter.

Marty Mosby - *Guggenheim Securities - Analyst*

Exactly. Lastly I just wanted to ask you about a $74 billion pipeline. Typically seasonally there is a swoon in applications and activity, and that starts to pick back up as we get into spring and summer. That would be a pull through. You could see originations still hovering in the $100 billion range, given your starting point is already three-fourths of the way there for the quarter. Just thought I would ask about that, your thoughts there.

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

Well, Marty, I think you are correct in that the pipeline was very strong. It was about what we saw a year ago at this time. Again I think that the complexion of the pipeline is a little bit different because a bigger percentage relates to purchase money activity.

I don't know what the originations are going to be for the quarter. I think the other thing to remember -- and I referred to it but probably could've been a little bit clearer. And that is that we have the appropriate level of staffing to take advantage of opportunities out there in the mortgage business. That has allowed us to reduce the application-to-close period from about 90 days to 60 days.

So you can't really see that in the numbers, but that would portend some pretty good origination activity. But in terms of what the number is going to be, we don't know for sure.

Marty Mosby - *Guggenheim Securities - Analyst*

Appreciate it. Thanks.

Operator

Greg Ketron, UBS.

Greg Ketron - *UBS - Analyst*

Good morning. Tim, a question on servicing. I know you've touched on this a number of different ways. But when you think about servicing going forward and where it is valued today at around 70 basis points if you just look at the residential side of it, and anticipate the rates do drift higher,

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you've got a slowdown in prepayment speeds, potentially you could see a pretty sizable write-up in MSR valuations -- $5 billion, $6 billion if we got back to 100 to 110 basis points ultimately.

Would it be your anticipation that you would recognize most of that or hedge that away as that develops? Could that be a future source of income in terms of running the balance, the mortgage model?

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

It certainly could. I don't know if I would necessarily agree with the $5 billion to $6 billion; but certainly we could see an increase in value of the servicing asset as rates go up.

I'd also just want to make clear that as housing values go up that actually -- when you think about modeling that out that also potentially has a negative impact on the servicing value, because it is more likely that our customers could refinance as valuations go up. So there is a little bit of a put and take there.

But there is no question that one of the benefits of the balanced model is that when you've got a servicing asset and rates go up it becomes more valuable. So that could be a source of earnings in the future.

Greg Ketron - *UBS - Analyst*

Okay. That is something you wouldn't necessarily hedge away, given the fact that you were in the balanced model?

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

Well, we currently -- well, we want to make sure that we have got the mortgage servicing asset appropriately hedged, and we are not going to speculate on interest rates in terms of how we hedge that asset, because we could just as well be right as wrong. So my guess is that we will get some benefit, but it is not as if we are going to make a decision one morning to completely unhedge the portfolio because we think -- or the asset because we think that rates are going to go up. That would be a very, very bad decision.

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

Yes, let me just reiterate what Tim said here. Part of our balanced model is we don't speculate. We don't try to speculate in this business around where we think interest rates are going to go.

We could've been sitting here a year ago and said they have to be going up, and actually they went down. So the balanced model is more around when rates are higher we have more value in the servicing asset, and when rates are lower we tend to do more gain on sale with production.

So, no. Surely those two are related to one another, but we are not in the business of speculating where rates -- or taking a view on rates and then adjusting the hedge accordingly.

Greg Ketron - *UBS - Analyst*

Okay, great. Then, John, a question for you. At the Investor Day last year you had spent time talking about the Wachovia franchise, the Eastern US, and how you had the opportunity there. As you have achieved the record earnings and deposit growth and the revenues in areas such as Wealth Management, can you give us some color on how that is progressing? What kind of leverage you are receiving out of the Wachovia franchise at this point and maybe percentage of the way through that optimization.

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

Sure, well first of all, I want to tip my hat to all the team members who helped make that merger the best one I have been around. And it was the largest, of course, in US bank history.

It is so rewarding to see the activity happening in the East with adding stores, adding team members in stores. In fact if you look at productivity numbers -- sales per day, referrals, cross-sell -- the gap is closing rapidly. In fact, some the best innovations and ideas we are getting now for future growth come from our newest team members.

In fact it is hard to distinguish East from West anymore. It is quite pluralistic in its performance.

So it is hard for me to give a percentage. I think we can get better across the franchise. But there is -- I just couldn't be happier with it.

If I had to pick a percentage I would say well into the final quartile of performance closing. It has just been that good. And we continue to add people there, incidentally.

Greg Ketron - *UBS - Analyst*

Okay. Great. Thank you very much.

Operator

Chris Mutascio, KBW.

Chris Mutascio - *Keefe, Bruyette & Woods - Analyst*

Good morning, John. I had a follow-up question on the MSR. When you look at the MSR and the black box accounting that goes around it, it certainly looks that from a historical perspective it is undervalued. I am not sure if we get back to the [150] level of loan service for others back in 2006. But it certainly looks undervalued relative to the historical perspective.

I know you have looked at it as a natural hedge or a partial hedge to production activity in a balanced approach. But what if that block box accounting creates a timing difference between when that asset is written up and when the production and gain on sale starts to fall?

If that occurs, would you consider more, I guess, strategic sales of MSRs rather than the nonstrategic sale of the reverse mortgage portfolio you just did, in order to harvest the gains that you can't harvest from an accounting perspective?

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

So, Chris, let me just push back a little bit, in that we don't consider the accounting in and around the MSR as black box accounting. We follow generally accepted accounting principles that are reviewed both internally and externally, and we think they are very sound. I know there are some commentators that are out there that get confused by generally accepted accounting principles and think that they are hard to follow, but they are not.

Having said that, I think the fundamental part of your question is that -- when we look at the MSR, it is a -- or step back for a minute. When we look at the servicing business it is a really good business. The servicing business has been so valuable for us over the last few years, but in particular it has been very valuable over the last couple of years because of the fact that it has put us in position to be able to originate as many refinance opportunities as we have and which has just been terrific.

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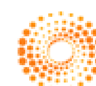

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The capital implications of the MSR given the new Basel III capital rules makes that -- creates an overlay over the asset itself, in that it could be in certain circumstances a potential deduct to capital levels. That is just something that we need to take into consideration, and it is something we think a lot about.

As we have said, from time to time it may make sense to consider selling some of the MSR. We have sold [s-deck] servicing in the past. We sold the reverse mortgage, part of the reverse mortgage MSR last week, which we were pleased with. So that could happen from time to time.

But it doesn't change our view that the servicing business is a very important business for the Company and is very valuable at all times, but in particular like the period we have been through.

Chris Mutascio - *Keefe, Bruyette & Woods - Analyst*

Thanks, Tim. I wasn't suggesting that you're performing the black box accounting. I just meant that -- the point being is that with the yield on that portfolio being as low as it is, probably has never been lower, that the inherent value of that asset over time is certainly going to be higher than what is on the balance sheet today.

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

Oh, completely agree --

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

I agree.

Chris Mutascio - *Keefe, Bruyette & Woods - Analyst*

I hope you didn't take my question the wrong way. Okay. Thank you very --

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

No, I just wanted to clarify, that's all.

Chris Mutascio - *Keefe, Bruyette & Woods - Analyst*

All right. Thank you very much.

Operator

Brian Foran, Autonomous Research.

Brian Foran - *Autonomous Research - Analyst*

Just on the gain on sale outlook, I recognize correspondent is a lower gain on sale than retail. But would you expect them to come down by about the same magnitude over the course of the cycle, or is one channel out likely to outperform the other?

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

Oh, I think if you have looked at the gain on sale historically it has been all over the place, on a comparative basis, between the two channels. My best guess is they will probably come down at about the same level. But I don't know for sure.

Brian Foran - *Autonomous Research - Analyst*

Got it. Then just one follow-up on the general comments about housing improvement. When we look at the Pick-a-Pay portfolio and where it is marked in the accretion, is there any kind of background you can give us on the home price assumptions embedded in that?

Or just more generally if your positive view of housing comes to fruition, would the Pick-a-Pay portfolio perform based on the current scheduled accretion, or would that represent upside to the current schedule of accretion?

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

I think it represents some upside. I don't know -- and we were very clear when we updated the amount of non-accretable -- or brought non-accretable to accretable and updated the estimate of cash flows last year in the third quarter that if we continued to see an improvement in not only the housing market but also in terms of the performance of the underlying asset, because that is a very important part of the valuation, that we could see some upside.

That didn't happen this quarter. But given the continued improvement it certainly could over the next few quarters.

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

Yes. In fact as I mentioned in my comments, we have a positive view, surely in the near-term outlook, about steady gains, gains in home sales, building activity, and price depreciation. We are seeing that in most of the markets or frankly the lion's share of the markets.

And when that happens, good things happen here on all things related to real estate. It is better for our home-equity portfolio, for our first mortgage portfolio, it is better for production activity in the mortgage companies. So surely things are improving.

Brian Foran - *Autonomous Research - Analyst*

Lastly, just if I read it right, I think there was a sale of some of the PCI loans and that, I guess, pulled forward some of the accretion. With a rising market would you expect to continue to sell some of the PCI loans? Or was that just a one-off?

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

We will look at that opportunistically. We had a $150 million gain from that, and that was -- and if we find opportunities we surely will do what we think makes most sense for our portfolio and for our stockholder.

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

Yes, I think that just to reinforce that we marked this portfolio four years ago and we just could not be more pleased with the performance. And the expectations will change over time, but if there is an opportunity to pull through some of that, our forecasted accretion, we are going to go ahead and do that.

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Brian Foran - *Autonomous Research - Analyst*

Thanks for taking my questions.

Operator

Ken Usdin, Jefferies.

Ken Usdin - *Jefferies & Co. - Analyst*

Thanks a lot for taking my question. Good morning. I just wanted to ask a bigger-picture expense question. A couple of the pieces have been asked.

But Tim, you mentioned that expenses are still too high. We know about the seasonality that can happen from first to second, and we know you will make adjustments against the mortgage business. So what I wanted to try to understand is when you say that expenses are still too high, what can you do to work on that underneath? How much from Project Compass is there to still just recognize?

And then what areas are you actually investing in, and what is the magnitude of that investment, versus what you can do to control things otherwise?

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

Again, I think that the focus of the Company is to improve our expense efficiency. So when I say and we say that expenses are too high given the current level of revenue, we think that we can improve our efficiency, which is why we have that range of 55% to 59%. There is no one magic change that we can make, that if we can just get through a certain project that it will get us down to 55%. It is really a function of lots of projects all around the Company.

It is improving the efficiency of our corporate properties and all of our square footage. It is improving -- it is using technology to reduce costs in our businesses; so sometimes there is some investment related to that. It is continuing to make sure that our folks are all in the appropriate locations.

And it is little things. There is literally hundreds of projects going on right now in the Company such that we are focused on reducing costs. So I would love to be able to give you two big items, but it is just not really the way it works now that we are done with the integration.

But I would also reinforce that apart and separate from the proactive projects that we have, the environmental costs are continuing to come down. So that we see with an improving economy, particularly an improving residential mortgage business, that we could continue improvement in our environmental costs apart and separate from anything else we are doing internally. John, I don't know if you want to --?

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

Yes, I would add to that that we are making investments, and we want to continue to make those investments. And we won't be, as I said before, slavish to anything here.

Because for example, we are doing wonderful, innovative things to help customers on the things mobile and tablet-wise. We just talked a few minutes ago about our neighborhood store. We are making investments, frankly, in compliance and governance, all kinds of different things.

On the other hand some things, just because you did it that way for 20 years doesn't mean you need to do it for the next 20 years. And we are finding different ways to improve customer service, customer loyalty, deepening relationships, at the same time getting rid of expenses that don't add value.

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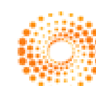

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Tim mentioned a few seconds ago just space. Four years ago we had about 115 million or 116 million square feet; now we are down to 95 million square feet or 98 million. Something -- it is down 10%, 12%. And yet we have more people, more customers, more products, more services, and I think that is the magic here, to continue to invest.

But we do all agree we can still do more. And this is a bottoms-up exercise, and it is just part of doing business. There is no destination here. This is a journey.

Ken Usdin - *Jefferies & Co. - Analyst*

And then -- thanks for that color. This is the last offset, adjunct to that is then just -- a lot of the things that you just mentioned, John, are very much about deepening relationships with customers, improving the experience. Are there any parts of the investment cycle that are now also paying off on a clear incremental revenue side? Because I think that is part of the investment part of the process that people also want to appreciate, too.

What are the investments that you are making that are also -- you are actively seeing an improved -- getting operating leverage off of?

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

Sure. For example, adding more bankers in stores and getting referrals to the mortgage company. Having ATMs that you give you paperless receipts. Taking paper out of stores and not having to have as many Brinks pickups. The way people can now buy products and services on their mobile devices and other self-service activities.

It is a number of things that help reinforce this when, where, and how people want to be serviced. So it's -- there is actually a lot of innovation going on in the industry. More of it happens to be within creating this distribution community, whether it be on the small business, large business, consumer side, as opposed to a different whizbang kind of product. It is much more about the overall service and availability.

Ken Usdin - *Jefferies & Co. - Analyst*

Got it. Then last tiny thing, just a follow-up to Brian's last question. When you mentioned the potential for non-accretable difference to be moved back into accretable yield, is any of that potential in your outlook for improving NII this year?

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

No, not really. Because recall that in the third quarter of last year when we made the adjustment and we moved some of the non-accretable to accretable and also increased our expectation of cash flows, even though when you total it up it was over $4 billion in total, because the average life of the underlying loans is 12 or plus years the incremental increase in terms of net interest income or net interest margin in a given quarter is actually relatively small.

It will have some impact. But it is not a primary driver for why we think net interest income can go up in this environment.

Ken Usdin - *Jefferies & Co. - Analyst*

Yes, perfect. Understood. Thanks, guys.

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

Thank you.

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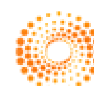

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John Stumpf - *Wells Fargo & Company - Chairman, President, CEO*

And thanks again. We ran over a little time here, but thank you for your interest in Wells Fargo, for your questions. We are always available to you and we will see you next quarter at the same time. Thanks again.

Operator

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

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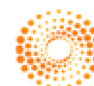

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