Company Name: Wells Fargo
Company Ticker: WFC US
Date: 2014-07-11
Event Description: Q2 2014 Earnings Call

Market Cap: 271,201.42
Current PX: 51.49
YTD Change($): +6.09
YTD Change(%): +13.414

Bloomberg Estimates - EPS
Current Quarter: 1.020
Current Year: 4.099
Bloomberg Estimates - Sales
Current Quarter: 21039.571
Current Year: 84013.462

Bloomberg Transcript final

Q2 2014 Earnings Call

Company Participants

- James H. Rowe
- John G. Stumpf
- John R. Shrewsberry

Other Participants

- John Eamon McDonald
- Joseph Morford
- Erika P. Najarian
- Kenneth M. Usdin
- Mike L. Mayo
- Betsy L. Graseck
- Matt D. O'Connor
- Keith E. Murray
- Brian D Foran
- Moshe A. Orenbuch
- Paul J. Miller
- Chris M. Mutascio
- Nancy Avans Bush
- Andrew Marquardt

MANAGEMENT DISCUSSION SECTION

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 second 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.

James H. Rowe

Thank you, Regina, and good morning, everyone. Thank you for joining our call today where our Chairman and CEO, John Stumpf, and our CFO, John Shrewsberry, will discuss second quarter results and answer your questions.

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

I'd 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 8K filed today containing our earnings release and quarterly supplement.

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

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

John G. Stumpf

Thank you, Jim, and good morning to everyone. Thank you for joining us today. The second quarter was another strong quarter for Wells Fargo. We earned $5.7 billion in the quarter by our continued focus on creating long-term shareholder value through meeting our customers' financial needs including growing loans and deposits and deepening our relationships with our customers.

Let me highlight our growth during the second quarter compared with a year ago. We generated earnings of $5.7 billion, up 4% from a year ago and earnings per share of $1.01 per share, up 3% from a year ago.

We had strong and broad-based loan growth and our core loan portfolio is up $51.3 billion or 7%. Our credit performance continued to improve with total net charge-offs down $435 million or 38% from a year ago and our net charge-off ratio was only 35 basis points annualized on average loans.

Our outstanding deposit franchise continued to generate strong growth with total deposits up $97 billion or 9%. We've grown deposits by an average of $265 million every day over the past year.

We deepened relationships across our company. Retail banking cross-sell was 6.17 products per household. Wholesale Banking cross-sell was 7.2 products, and Wealth, Brokerage, and Retirement cross-sell was 10.44 products.

We reduced expenses from a year ago while we continued to invest in our businesses including strengthening our risk management infrastructure.

We also followed through on our commitment to maintain strong capital ratios while returning more capital to shareholders. In the second quarter, we increased our common stock dividend by 17% and continue to reduce our share count. We returned a net $3.6 billion to shareholders in the second quarter, up significantly from $1.6 billion a year ago.

I'm also proud that during the second quarter, Wells Fargo was ranked the most respected bank in the world and the 11th most respected company overall according to Barron's magazines 2014 ranking of the world's most respected companies. This recognition is a result of our dedicated team members remaining focused on our consistent vision and their commitment to meeting our customers' financial needs.

While the economic recovery remains uneven, there are many indicators that economic growth is accelerating and we remain optimistic about the opportunities the recovery provides for Wells Fargo and for our customers.

The strong improvement in employment in June demonstrated the strength in the labor market with unemployment at the lowest level since September 2008. The housing market rebound remained on track with home prices up 8% from a year ago and up 25% from the low in June 2011.

Despite these increases home affordability continued to remain attractive due to historically low mortgage rates and rising household incomes. In June, the conference board's measure of consumer confidence reached a six-year high and vehicle sales reached an eight-year high. The economy is also benefiting from strong energy production with domestic crude oil production running at the highest level in 26 years and our reliance on foreign energy resources has been falling for nearly a decade.

I am confident that the economic recovery and our diversified business model will continue to provide opportunities for future growth as we remain focused on helping our customers meet their financial needs.

Now, John Shrewsberry, CFO, will provide more details on our second quarter results. John?

John R. Shrewsberry

Thank you, John, and good morning, everyone. My comments will follow the presentation included in the quarterly supplement starting on page two. John and I will then answer your questions.

Wells Fargo had a very strong quarter, as demonstrated by fundamental drivers of long-term growth. We earned $5.7 billion in the second quarter, down $167 million from the first quarter. but keep in mind our results last quarter included a $423 million discrete tax benefit, an $0.08 per share impact. Our pre-tax income grew $303 million from the first quarter.

Revenue grew from first quarter, including both net interest income and non-interest income. Core loans grew 8% annualized, and average deposits grew 9% annualized. We grew pre-tax pre-provision profit for the third consecutive quarter, and credit quality continued to improve. Capital remained strong and we returned more capital to shareholders. I will highlight the drivers of this growth throughout the call today.

As John highlighted and as you can see on page three, we had strong year-over-year growth in loans and deposits. Our growth in EPS and net income reflected this benefit along with the reduction in expenses and an improvement in credit quality. Our results were driven by momentum across many of our businesses. One way to demonstrate this business momentum is through non-interest income growth. Mortgage fees, while up from first quarter, were down $1.1 billion from a year ago due to lower refinancing volume. Excluding mortgage fees, fee income was up 9% from a year ago, reflecting broad-based growth in retail brokerage, deposit service charges, card fees, commercial real estate brokerage commissions, trust and investment management, merchant processing, and market sensitive revenue. That's the benefit of our diversification. We have over 90 businesses focused on meeting our customers' financial needs.

We also grew net interest income from a year ago. And as you know, growing net interest income measured in dollars has been our focus, as deposits and other sources of liquidity have grown more rapidly than loan demand or other attractive investment opportunities.

Page four highlights our revenue diversification. While our balance between net interest income and non-interest income has been consistent, the drivers of non-interest income can vary each quarter. For example, equity investments were 9% of our fee income in the first quarter but declined to 4% in the second quarter. Other businesses such as deposits, investment banking and mortgage, contributed more to fee income this quarter, resulting in overall fee income growth, demonstrating the benefit of our diversified business model.

Let me highlight some of the key drivers of our second quarter results from a balance sheet and income statement perspective, starting on page five. Our balance sheet has never been stronger. Capital, liquidity, asset quality, funding mix are all exceedingly strong. We increased average earning assets by 3% from the first quarter by growing loans, increasing short-term investments and trading assets and purchasing securities. In addition, our credit quality continued to improve.

Investment securities increased $8.7 billion from first quarter, reflecting $17 billion of purchases, primarily U.S. Treasuries and federal agency debt partially offset by runoff. We also improved our liquidity position in response to continued heightened regulatory expectations. We issued $7.8 billion of liquidity related long-term debt and increased liquidity related short-term funding by $5.9 billion. Total short-term investments grew to $238.7 billion, which helps us meet our regulatory obligations and provides dry powder to grow loans and invest in securities.

Turning to the income statement on page six, revenue grew $441 million, with growth in both net interest income and non-interest income. The $246 million growth in non-interest expense was primarily due to higher revenue based incentive compensation and deferred compensation expense and an increase in operating losses, primarily from litigation accruals related to various legal matters. I will explain the drivers of our expenses in more detail later on the call. Income tax expense increased from the first quarter, which included a $423 million discrete tax benefit.

As shown on page seven, we continued to have strong broad-based loan growth in the second quarter, our twelfth consecutive quarter of year-over-year growth even with the continued reduction in our liquidating portfolio of $56.5 billion over the same time period. Our core portfolio, which excludes our liquidating portfolio, grew by $51.3 billion or 7% from a year ago and was up $15.2 billion or 8% annualized from the first quarter.

Period-end loans were up $29 billion or 4% from a year ago and up $2.5 billion from the first quarter. This growth was impacted by the transfer of $9.7 billion of government guaranteed student loans to held-for-sale, which removes them from total loans. These student loans have been included within our liquidating portfolio since we stopped originating them into 2010. We transferred this portfolio to held-for-sale at the end of the second quarter, reflecting our intent to sell our entire government guaranteed portfolio. However, we remain committed to the private student lending business. Excluding this transfer, total loans would have increased to $12.2 billion or 6% annualized linked quarter.

On page eight, we highlight how broad-based our loan growth continues to be at Wells Fargo. C&I loans were up $19.4 billion or 10% from a year ago, as we successfully grew loans across our commercial businesses, including asset-backed, corporate, government, commercial, and asset-based. Real estate 1-4 family first mortgage loans grew $7.3 billion or 3%, with growth in high quality non-conforming mortgages, primarily jumbo loans. Foreign loans grew $6.2 billion or 15% from a year ago, reflecting growth in trade finance and the UK commercial real estate acquisition we completed in the third quarter of last year.

Auto loans were up $5.5 billion or 11%, reflecting strong originations, as we remain the number one auto lender in the country while maintaining our focus on pricing for risk. Commercial real estate loans were up $4.4 billion or 4%, reflecting new originations and an acquisition in the third quarter of last year. Credit card balances were up $2.4 billion or 10%, with new accounts up 4%. Our growth rate has been above the industry average, reflecting new account growth, product enhancements, and increased usage among our existing customers.

Deposit growth also remained strong in the second quarter, with average deposits growing $91.7 billion or 9% from a year ago and up $24.2 billion from the first quarter, up 9% annualized. Average deposits totaled $1.1 trillion, and we benefited from strong growth in both commercial and consumer balances. Our average deposit cost declined to 10 basis points in the second quarter, down one basis point from the first quarter and down four basis points from a year ago. Our ability to generate strong deposit growth while reducing deposit costs demonstrated the fundamental strength of our outstanding deposit franchise.

We've been able to grow deposits by offering best-in-class products, an excellent customer experience, and robust multi-channel options. Our primary consumer checking customers were up 4.6% from a year ago. Our ability to grow primary customers is important to our results because these customers have more interactions with us, have higher cross-sell, and are more than twice as profitable as non-primary customers.

As shown on page 10, tax equivalent net interest income increased $184 million from first quarter benefiting from an additional day in the quarter, organic loan growth, and higher mortgages held for sale and trading assets. Our NIM declined from the first quarter to 3.15%, driven by customer deposit growth, which was essentially neutral to net interest income but reduced the margin by approximately five basis points.

Liquidity related actions we took in the second quarter to meet increased regulatory liquidity expectations reduced the margin by one basis point. However, higher income from variable sources including higher PCI resolutions and periodic dividends offset this decline. Balance sheet repricing and growth once again did not impact the NIM this quarter, as the majority of the repricing from the higher rate environment to the current rate is behind us.

Non-interest income increased $265 million from the first quarter, with growth across our diversified businesses, including mortgage banking, investment banking, deposit service charges, card fees, retail brokerage, commercial real estate brokerage, and insurance, offsetting a $460 million decline in market-sensitive revenue. Market-sensitive revenue declined 34% from first quarter while all other non-interest income grew 8%.

Trust and investment fees increased $197 million or 6% from first quarter on higher investment banking and retail brokerage asset-based fees. Mortgage banking grew $213 million from first quarter, up 14%, with growth in both originations and servicing. The second quarter benefited from a seasonally stronger purchase market, with 74% of our

originations coming from home purchases, up from 66% last quarter. Total originations increased to $47 billion, up 31%. Our unclosed pipeline increased to $30 billion at the end of the quarter, up 11%. We also continued to see improvement in our net servicing results, with servicing revenue up $97 million from the first quarter, reflecting higher MSR hedge performance and an increase in net servicing fees, reflecting the benefit of lower servicing and foreclosure costs.

As shown on page 12, expenses were up $246 million from the first quarter while our efficiency ratio remained at 57.9%, reflecting our revenue growth. The key drivers of our expenses included personnel expenses declined $106 million from the first quarter, which included seasonally elevated incentive compensation and benefit costs. Salaries increased as expected due to annual merit increases and one extra day in the quarter. Personnel expenses included $130 million of higher revenue based incentive compensation in the second quarter, which is a type of expense increase we like to see because we're growing the top line. Additionally, personnel expenses were impacted by $84 million in higher deferred compensation expense, which is offset in trading revenue.

Outside professional services and advertising expenses increased from the first quarter levels, which tend to be seasonally lower. And operating losses increased $205 million from the first quarter largely due to litigation accruals for various legal matters. We remain focused on managing expenses and we expect our efficiency ratio will remain within our target range of 55% to 59% for the third quarter.

Turning to our business segment starting on page 13, Community Banking earned $3.4 billion in the second quarter, up 6% from a year ago and down 11% from first quarter primarily from higher taxes. Retail banking cross sell was 6.17 products per household, up from 6.14 a year ago. Our debit and credit card businesses continued to grow, benefiting from account growth and higher usage. Debit card purchase volume was up 8% from a year ago, driven primarily – driven by primary checking customer growth.

Credit card purchase volume was up 16% from a year ago with new account growth and more active accounts. Active accounts were up 14% as the Wells Fargo credit card is becoming more top-of-wallet for our customers. Credit card household penetration increased to 39%, up from 35% a year ago.

We remain committed to serving our small business customers and have increased primary business checking account customers 5.2% from a year ago. During the second quarter, we launched Wells Fargo Works for Small Business, an initiative that provides guidance and services to small business owners. This new initiative has resulted in strong engagement with small businesses across the country, including millions of views of our online video series and increased traffic to wellsfargoworks.com.

Wholesale Banking earned $2 million in the second quarter, down 3% from a year ago and up 12% from the first quarter. Loan growth remains strong and broad-based across businesses, up 8% from a year ago and up 2% from first quarter. Capital finance increased $2 billion for first quarter, driven by higher utilization rates, new customer growth and growth in factoring assets. Commercial banking grew $1.8 billion from the first quarter with widespread growth across geographies and industries. Commercial real estate grew $1.4 billion driven by new loan originations including customer M&A activity. In addition, corporate banking, government and institutional banking, asset-backed finance and equipment finance portfolios all grew from the first quarter.

Revenue increased 7% from the first quarter reflecting diversified growth across a number of Wholesale Banking businesses. Investor banking revenue growth was broad-based across product categories. Eastdil Secured, our commercial real estate brokerage business increased revenue with strong performance in public and private markets. Asset management fees grew from increased market valuations and inflows.

Total assets under management increased $35 billion from a year ago. Long-term assets including equity and fixed income strategies were up 12% while money market funds have declined by 4% from a year ago. This shift out of money market funds moderated growth in total assets under management, but revenue benefited from the shift to higher fee generating long-term assets. Wholesale Banking revenue also benefited from the sale of 40 insurance offices in the quarter.

Wealth, Brokerage and Retirement earned $544 million in the second quarter, up 25% from a year ago and up 15% from the first quarter. The strong year-over-year results reflected 9% revenue growth driven by recurring revenue. Net interest income was up 11% from a year ago and asset-based fees were up 14%, benefiting from market performance and continued client demand for plan based advisory solutions. Our brokerage advisory assets have grown to $409 billion, up $78 billion or 24% from a year ago.

Loan growth remains strong with average loans up 12% from a year ago, driven by growth in high-quality non-conforming mortgages and security-based lending. We also benefited from the partnership involving WBR and Community Banking to better meet our new customers savings, retirement planning, and investment needs and we increased the number of private bankers in our banking stores by 22% from a year ago.

Turning to page 16, credit quality continued to improve with second quarter credit losses down $108 million from first quarter and the net charge-off ratio declining to 35 basis points of average loans. Losses in our commercial portfolio were only three basis points of average loans and consumer losses continued to decline to 62 basis points. Non-performing assets have declined for seven consecutive quarters and were down $686 million from first quarter, although the pace of improvement has slowed. We had a $500 million reserve release, the same as in first quarter. We continue to expect future reserve releases absent a significant deterioration in the economy, but expect a lower level of future releases as the rate of credit improvement slows and the loan portfolio continues to grow.

Our estimated common equity Tier 1 ratio under Basel III using the advanced approach fully phased in increased to 10.09% in the second quarter. Our share count declined in the quarter reflecting the repurchase of 39.4 million common shares and we executed a $1 billion forward repurchase contract that's expected to settle in the third quarter for approximately 19.4 million shares. We expect our share count to continue to decline throughout 2014 as a result of anticipated net share repurchases. We also increased our dividend to $0.35 per share in the second quarter, a 17% increase. Our net payout ratio in the second quarter was 66%, in line with our recent guidance of 55% to 75%.

In summary, our results in the second quarter demonstrated the momentum across our fundamental business drivers including growing loans and deposits, increasing both net interest income and non-interest income while credit improved and capital remained strong. While we have demonstrated our ability to grow during a variety of economic and interest rate environments, we are well positioned to benefit from an improving economy and higher rates. Our diversified business model provides us with many opportunities to better meet our customers' financial needs as economic growth becomes more robust. Our strong balance sheet with our large balance of short-term investments primarily driven by our strong deposit growth provides us the ability to further grow loans and invest in securities. We are optimistic that our outstanding franchise and our focus on serving the real economy will continue to produce strong results.

We will now open the call for your questions. Jim?

Q&A

Operator

[Operator Instructions] Our first question will come from the line of John McDonald with Sanford Bernstein. Please go ahead with your question.

<Q - John Eamon McDonald>: Hi. Good morning. John, I was wondering on the legal side of things, can you give us a sense of what type of legal issues you're building reserves for and also can you comment whether you're having discussions with the DOJ and mortgage task force made up of state AGs that other banks are having discussions with?

<A - John R. Shrewsberry>: The best disclosure for our legal activities are found in our Q and our K were there's great detail on items that are probable and estimable and frankly even more matters. We can't comment on anything specifically. The items that I referred to in the expense section are a variety of matters that essentially added up to the number you saw.

<Q - John Eamon McDonald>: Okay. On the loan growth, can you comment what you are seeing in terms of utilization of lines by your customers, is that getting better? What's driving what appears to be a slight kind of acceleration in the loan growth you saw this quarter?

<A - John R. Shrewsberry>: Well, we called out one area where there has been an increase in utilization in the comments and that was in capital finance but, overall, in Wholesale Banking, utilization is relatively flat. It ticked up just a little bit, so this loan growth isn't just driven by that.

<A - John G. Stumpf>: John, the nice thing about the loan growth, it's broad-based. If you look at it, it's consumer, it's private banking area, commercial across. So it's really very broad-based and it's one of the, I think, the strengths in what we have been doing the last number of quarters but especially this quarter.

<Q - John Eamon McDonald>: Okay. And then last thing from me, John, on the net interest income side of things, do you know at this point, is the liquidity building that you've been doing, is that done or are you not sure yet on that front?

<A - John R. Shrewsberry>: We think that where we stand today is probably about where we need to be, and if the final rule-making around LCR comes in a little bit differently, than the actions that we have to take shouldn't materially change things. So, we're about where we need to be.

<Q - John Eamon McDonald>: Okay. And it seems that the churn has stopped with your reinvestment rates kind of looking like they match your roll-off rates. So I guess with that perspective in mind, are you looking to grow net interest income dollars, kind of, in line with loan growth from here or are there other factors we should think about?

<A - John R. Shrewsberry>: Well, we should look at the balance sheet at every period end and assess what types of inflows we've had of additional liquidity and what we've done with it. Some of it will be loan growth. There'll be more security growth. There will be some that sits in cash while we wait to make to decisions about securities investment. So the facts and circumstances will lead you down that path, but back to answer your question about roll-off and roll-on, it appears that NIM isn't being diminished by a changing pricing scheme with respect to loans or securities for that matter because of what you described.

<Q - John Eamon McDonald>: Okay. And you're still looking to grow net interest income from the current levels, you still think you can do that?

<A - John R. Shrewsberry>: We are...

<A - John G. Stumpf>: Absolutely.

<Q - John Eamon McDonald>: Okay, great. Thanks, guys.

Operator

Your next question will come from the line of Joe Morford with RBC Capital Markets. Please go ahead with your question.

<Q - Joseph Morford>: Thanks. Good morning, everyone.

<A - John R. Shrewsberry>: Hi, Joe.

<Q - Joseph Morford>: Hey, there. I guess first was just following up on John's question on the loan growth. I guess specifically in C&I, end of period loans were up a little over $9 billion or almost 5% sequentially, the strongest increase over the past year. I was just curious a little bit more, what's driving that? Are you seeing signs of increased confidence among borrowers and maybe more of a willingness to make investments?

<A - John G. Stumpf>: Joe, this is John Stumpf. We are seeing that. As I'm out talking with customers and talking with our team, there is, as I mentioned in my opening comments, there is more optimism. I think consumer confidence

is at a six-year high. It's not break out, but it's – we are having more discussions with more customers about buying homes, buying autos, investing in infrastructure if you are a business, buying something. So we are a real economy company. We're in the real economy and there are certain sectors of the economy that are doing very well. We are a big energy lender, both on renewable side and the hydrocarbon side. Commercial real estate has been very good for us, middle market, so it's very broad-based.

<Q - Joseph Morford>: Okay, that's great. Thanks. I guess the other question was just could you talk a little more about what your experience has been in mortgage with the spring selling season? And how do you feel about both volumes and staffing levels for the rest of the year there?

<A - John R. Shrewsberry>: Sure, we've been pretty clear on the record that we found the spring selling season to be a little less than we originally imagined, although it's nice growth from the first quarter just based on the time of year. And our view on the whole year in terms of mortgage origination is not inconsistent with the MBA [Mortgage Bankers Association] and other published metrics. So you can see our pipeline going into the third quarter higher than it was going into the second, so that probably means good things for the third quarter relative to the second quarter. The margins are holding in there, but we're not seeing breakout returns to pre-crisis levels of the enthusiasm around homeownership and so the purchase market is softer than we thought that it would be.

<Q - Joseph Morford>: And is that likely to drive any rightsizing on the staffing side or do you feel pretty good about where you stand there?

<A - John R. Shrewsberry>: I think we've been very good at being flexible about that workforce and adding as we needed to as production volumes increased and then making changes as production volumes decreased. So I think we're keeping that in sync with the production opportunity.

<Q - Joseph Morford>: Okay. Thanks very much, guys.

<A - John R. Shrewsberry>: Thank you.

Operator

Your next question will come from the line of Erika Najarian with Bank of America Merrill Lynch. Please go ahead with your question.

<Q - Erika P. Najarian>: Good morning.

<A - John G. Stumpf>: Hi, Erika.

<A - John R. Shrewsberry>: Good morning.

<Q - Erika P. Najarian>: Hey. My first question is a follow-up to John's line of questioning. The first is if you feel like you are where you need to be in terms of liquidity and the majority of the re-pricing from higher interest rate environment as you said, John, to the current interest rate environment is behind you. Can we assume that Wells Fargo's net interest margin is close to the bottom with the wild card being deposit growth being stronger – continuing to be stronger?

<A - John R. Shrewsberry>: I would say this way, Erika, again, we don't manage for the margin. Deposit growth has an impact on the margin. What we're saying is we're focused on growing net interest income and we believe we can do that. And loan demand has been good and that is good for growing net interest income. Secondly, we have millions of dollars available in that cash flow, if you will, to make investments at the right time. So we're optimistic about growing net interest income over the long term. The margin will be impacted by – deposit growth has a big influence on that. And again, most of that is neutral to income, it's not neutral to the margin.

<Q - Erika P. Najarian>: And the second follow-up question, just as we think about the next quarters earnings power, I noticed in the appendix that you did reclassify about $2 billion from non-accretable difference to accretable yield and

you're expecting the yield on the Pick-A-Pay portfolio or the accretable percentage should be 6.15% from 4.98% this quarter. Is that going to have a positive impact on net interest margin on a sequential basis as we take into account all the different components of the core balance sheet that we talked about so far in this call?

<A - John R. Shrewsberry>: You should think about that as worth about $65 million per quarter in terms of incremental accreted interest income. That's related to the $1.9 billion re-class from non-accretable yield to accretable yield, and over the life, that it will accrete under and based on the balance its related to.

<Q - Erika P. Najarian>: Got it. And just...

<A - John R. Shrewsberry>: Is that helpful?

<Q - Erika P. Najarian>: Yes. And the third follow-up question is another follow-up to John's. I know you're not going to answer any questions about litigation in depth, but I guess as we think about further accruals in your litigation reserve, can we expect as we think about the next few quarters, Wells Fargo continuing to maintain at 55% to 59% efficiency ratio despite potential higher operating losses from legal accrual?

<A - John R. Shrewsberry>: I would say that given everything that we know, we anticipate operating between 55% and 59%.

<Q - Erika P. Najarian>: Got it, thank you so much.

<A - John R. Shrewsberry>: Thank you.

Operator

Your next question will come from the line of Ken Usdin with Jefferies. Please go ahead with your question.

<Q - Kenneth M. Usdin>: Thanks, good morning. First question just on the mortgage business, I was just wondering if you could drill down on two things. First of all, just your general sense of the gain-on-sale environment; obviously, it's continued to reset lower, but do you think we've gotten to a more stable base here?

<A - John R. Shrewsberry>: Yes, I do. I think the margins have been running in that 140 to 160 basis points range. And from what we see today, there is rationality in pricing, and those margins look reasonable to us. We have no reason to believe it will be markedly different from that in the near future.

<Q - Kenneth M. Usdin>: And my second mortgage question is then, the servicing fees line has had a nice expansion, but with the book not growing and rates back down, so I'm wondering. Can you give us context of what the growth driver has been underneath that servicing fees line?

<A - John R. Shrewsberry>: It has a lot to do with servicing expenses, so fewer unreimbursed expenses coming through, fewer foreclosure and default expenses. So it's a more efficient servicing operation and more of the net fee is flowing to the bottom line.

<Q - Kenneth M. Usdin>: Okay, so we'll see all of that in the 10-Q?

<A - John R. Shrewsberry>: Yes.

<Q - Kenneth M. Usdin>: Okay. And then my third question is just on capital and capital return, clearly $0.35 dividend, year-end $1.01, so above the 30% threshold that we've known to be the benchmark. So given that we are now past this year's stress test, can you give us your thoughts around flexibility around above that 30% and your post-game on how you've looked at this year's stress test process in that regard?

<A - John R. Shrewsberry>: We think a 66% payout ratio with the combination of repurchase and dividend is an excellent spot to be in. It's between the goal post that we set up, 55% to 75%. I can't be much more precise than that, but we hear our shareholders loud and clear that they want more return of capital. We're committed to executing on that. So that's about all there is to say. And we're looking forward to our CCAR process.

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<Q - Kenneth M. Usdin>: Okay. And then my last tiny one related to that is just the buyback was bigger, the share count just dripped lower. How close are we to finally getting that average diluted share count really starting to move downward?

<A - John R. Shrewsberry>: That's a good question. You can see the point-to-point numbers that have changed. The average is what it is just because of the timing in the quarter between when we issued shares to our benefit plans and when shares were repurchased. The repurchase was a little bit more even throughout the quarter and the issuance was a little bit more front-end loaded, so the average didn't change as much as the point-to-point. But it will probably be like that during quarters where there's slightly heavier issuance, but yet we expect the net number to trend down the way we've described it.

<Q - Kenneth M. Usdin>: Okay, thanks a lot, guys.

Operator

Your next question will come from the line of Mike Mayo with CLSA. Please go ahead with your question.

<Q - Mike L. Mayo>: Hi. What was the amount of gain on the sale of the 40 insurance branches?

<A - John R. Shrewsberry>: About $100 million.

<Q - Mike L. Mayo>: Okay. And conceptually, was there anything that offset that? I guess you had the increase in litigation accruals of $200 million; anything else would be non-permanent?

<A - John R. Shrewsberry>: It's tough to describe expenses as permanent or non-permanent. I know you're looking for an offset for that non-recurring revenue, but the expense story is the efficiency ratio story. If we've got, for example, this quarter higher incentive compensation related to revenue growth, that's going to move things around. We've got our deferred comp hedging that moves things around. So it's hard to give you a neat offset to that.

<Q - Mike L. Mayo>: How about the run rate in minority expense? There is a decline and that helped a little bit. Is that permanent?

<A - John R. Shrewsberry>: It's hard to say whether that's permanent or not. We'll work with Jim Rowe and get you something specific so we can be responsive to that.

<Q - Mike L. Mayo>: Okay. And the increase in investment banking linked quarter was up a lot. Can you give any context to that?

<A - John R. Shrewsberry>: It's broad-based, so there's some equity capital markets, debt capital markets, loan syndications, M&A activity. It was just a busier quarter. I think that our investment banking share might have ticked up a little bit, but the whole market was busier in the second quarter than it was in the first quarter.

<Q - Mike L. Mayo>: And mortgage originations, as you mentioned, they were up linked quarter. And it seemed a little bit better than what you were saying at the Investor Day. So were things a little bit better and if so why? I know it's not as much as you originally thought of the spring selling season, but that's a little bit of a bump. And I guess you expect a little more of a bump in the third quarter.

<A - John R. Shrewsberry>: The gain was at the low end of the range, which is how we thought about it and described it at Investor Day. And in terms of volumes, I think we feel about the same as we did six weeks ago, which was it was less than we had originally anticipated. So we feel about the same. We're glad the results are good. They're certainly up seasonally quarter over quarter, but we might have imagined a little more going into the year.

<A - John G. Stumpf>: Mike, about 74% of our originations or our production this quarter was purchase-money, and that really plays into our hand. We have long-term relationships with realtors and builders. We have a wonderful group of people who are our team members who are out calling, so we should expect to do better vis-à-vis because others who

don't have a sales force that's on the ground.

<Q - Mike L. Mayo>: Okay. And then last question, I guess I'll ask two sides of the same question. Are you taking too much risk in an area such as auto lending, where loans are up 10% year over year? You've had some cautionary language from regulators, and it seems like every bank is expanding in auto lending. So are you concerned about that? On the other hand, are you taking enough risk because based on our models which go back a couple decades, it looks like your net charge-off ratio for the firm is the lowest ever in modern history, so that would say take more risk. So where do you come out on that decision?

<A - John G. Stumpf>: Mike, you hit both sides of it. I think, 35 basis points, it's the lowest I remember in my 30-some years with the company. In the auto area specifically, we look carefully at what's going on with FICO scores and we look at delinquency. There's a whole bunch of things there. So no, I don't think we are taking inappropriate risk. In fact, I think we're taking the right risk and we're finding the right place. After all, this is a business that we've been in a long time. We don't come in and show up and leave. And secondly, it's a short-dated asset that we know a lot about.

<A - John R. Shrewsberry>: And you'll probably recall at Investor Day, we had a specific slide and disclosure on the growth in the auto portfolio in particular that showed, among other things over a long period of time, what's been going on in our portfolio with FICO scores, average loan-to-value, and payment-to-income ratios of our auto customers. And each of those has improved not only over the last five years but improved meaningfully from pre-crisis levels. So the portfolio actually looks really good. Our relationship in autos and our business proposition there is that we own the relationship with dealers. We bank the dealers directly. We provide them with floor plan financing. We provide them with real estate financing. We bank them personally, and we're a very reliable takeout for indirect auto paper. And we get more than our fair share as a result of the paper that we want, and the portfolio composition reflects that.

<Q - Mike L. Mayo>: All right, thank you.

<A - John R. Shrewsberry>: Thank you.

Operator

Your next question will come from the line of Betsy Graseck with Morgan Stanley. Please go ahead with your question.

<Q - Betsy L. Graseck>: Hi, thanks so much, a couple questions. One is on the mortgage origination side, and I think you were doing some rollouts on July 1. I just wanted to see how that was executed. And now that that's behind you, are there any opportunities to make that side of the business more efficient?

<A - John R. Shrewsberry>: When you say rollouts, do you mean changes in head count?

<Q - Betsy L. Graseck>: There were some technology changes and some systems-related changes, process-related changes that you did effective July 1.

<A - John G. Stumpf>: Betsy, we've been doing a number of those over a period of time to be more efficient and to give our sales force more information at the point of sale, but that's not a big issue. I mean those things happen, that didn't have any impact on the business.

<Q - Betsy L. Graseck>: Okay. And then just looking forward a little bit less positive on the outlook for volumes for the full-year, is there any opportunity to peel back some of the investment in the production side of the business or are you sticking with your current plan at this stage?

<A - John R. Shrewsberry>: We are very flexible about that and constantly reading what we think we need in terms of capacity. As you know, the workforce in that line of business has become a flexible workforce just because of the ebbs and flows of the origination patterns as a refinancing opportunity comes into money and then goes away. So I think we're very real time in responding to what we think we need. And if we think that we need more because the third quarter opportunity seems bigger, then we'll step it up, and if we think we need less, then we'll dial it back.

<A - John G. Stumpf>: But Betsy, you're on an important point and I think it's been asked a couple of times this morning. In the mortgage business besides having to be good underwriters, good servicers and all those things, good at flexibility, ramping up and ramping down is a core competency here. And if you're going to be in this business, you have to be good at that.

<Q - Betsy L. Graseck>: And then...

<A - John G. Stumpf>: You never know where the volume is going to be.

<Q - Betsy L. Graseck>: Sure. No. And one of the things you did mention at Investor Day that Mel Watt, obviously, had some suggestions for underwriting and potentially changing some of the elements of the grid and I know that you had indicated that there were several meetings that you were going to be taking – that were taking place with you and others in D.C. around those suggestions. Can you .give us any sense as to how those dialogues have been going? Any update on how you're thinking about underwriting the credit box?

<A - John G. Stumpf>: Well, those meetings with our mortgage company continue with Mel Watt and his team and others. I think the goal here is to get more credit appropriately to borrowers who want to own homes and who can afford homes and that's in the interest of borrowers, interest of lenders like us, interest of investors and the country. So we are trying to harmonize that. Some things in the past created less harmony. You have low rates on one side encouraging borrowing and you have put-backs in the GSEs on the other side that make lenders less willing to lend money. So we're trying to get everybody on the same page. I think he's been helpful in that and obviously we're participating in that. As we get more clarity there, we can make loans, conforming loans that serve more customers. That's the goal here.

<Q - Betsy L. Graseck>: Okay. I know you spent a lot of time with the FHA, and that at the margin helped open the credit box in certain parts, I mean do you feel like you're at the stage where we're likely to see any changes come this year or it's really more of a next year event with the GSEs?

<A - John G. Stumpf>: Well, I tell you, predicting what happens in Washington on legislation is – that's way above my pay scale. But the important point is here is that there are some incremental changes happening and that's helping opening the credit box a bit and appropriately so. We're still doing full underwriting and those sort of things, but I'd hate to venture a guess on when GSE reform will become law.

<Q - Betsy L. Graseck>: I was asking really more about when your credit box on GSEs would loosen up potentially versus what has happened at the FHA where you've already loosened up a little bit there, so?

<A - John G. Stumpf>: I understand. Okay. We will keep working on that and I think there's a lot of emphasis on making sure, again, appropriate customers get loans that they can repay.

<A - John R. Shrewsberry>: And capturing that first-time buyer, that lower credit quality customer will be very important to that customer when credit becomes available, but it's not likely to change the overarching view of what the size of the mortgage market is in 2014 or 2015 and it's not likely to have a big impact on the earnings of mortgage originators because there's not that much going on there. It's very important to them, but there aren't enough of those loans at 140 basis points to make a giant difference.

<Q - Betsy L. Graseck>: Okay. Thanks a lot.

Operator

Your next question will come from the line of Matt O'Connor with Deutsche Bank. Please go ahead with your question.

<Q - Matt D. O'Connor>: Good morning.

<A - John R. Shrewsberry>: Good morning.

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<Q - Matt D. O'Connor>: It seems like from here, the efficiency ratio will be increasingly important just given how low the credit cost are at these levels and you talked about maybe some less reserve release going forward. So just as we think about that efficiency ratio being closer to the higher end, is there opportunity to migrate down in this environment and if so, how do we think about the expense opportunity versus growing revenues?

<A - John R. Shrewsberry>: Sure. Well, I will start out by saying we're sticking with our 55% to 59% because that's where we think we will be through the cycle. We constantly focus on our efficiency. We spend a lot of time and have many programs that are designed to root out and to get to the bottom of the most efficient use in resources that we can have. And that's important because there are areas where we continue to spend and invest money to have the right people facing customers and invest in the right products for customers. And there are also areas like risk management, compliance, technology, et cetera, where we're making increasing investments to build a better company for the future, so all that's going on at the same time, and it's what arrives at this 55% to 59%. You can rest assured that we're doing what we can to keep expenses efficient but I wouldn't count on a big lever there moving down closer to 55%, all other things being equal, to drive near-term performance.

<A - John G. Stumpf>: So a couple of examples of things that we're doing that you know about. Since the merger five years ago, we've reduced the number of square feet that we used to house our people and for our stores and so forth from, let's say, 115 million square feet or 117 million square feet to 94 million square feet, 95 million square feet. We are testing, and successfully so, a new urban store, if you will, neighborhood store. We now have three of those in the Washington area. It has a very different expense component, but still is just as productive. So there's lots of things we are working on so we can use those dollars and savings to invest in other areas of the business that John mentioned. The expense, there's a lot of focus on that here, but not again – I've said in the past, we're not slavish to it. If our expenses go up because revenue is going up, that's a good thing. And we will make the investments that we believe we need to make for the long-term success of the company.

<Q - Matt D. O'Connor>: Okay. So if I'm hearing you correctly as we think about the efficiency ratio going forward, maybe some opportunities for it to kick down a little bit, more dependent on revenue?

<A - John G. Stumpf>: I would say, yeah, surely it's a ratio. So it's a numerator and a denominator. We're working both sides of it.

<A - John R. Shrewsberry>: And as we said publicly in the past to the extent that we had revenue increases as a result of rates moving up, we'd probably migrate to the lower end of the efficiency ratio...

<A - John G. Stumpf>: Correct.

<A - John R. Shrewsberry>: ...because those dollars of revenue don't have expense attached to them.

<Q - Matt D. O'Connor>: Okay, I'm harping on it because the efficiency ratio hasn't really moved the last several quarters. So as we start thinking about the back half of the year and going forward, the mortgage revenue comps get a lot easier and it feels like we could start seeing some improvement there. So...

<A - John R. Shrewsberry>: Have you noticed that we're best in class at the ratio where we currently operate?

<Q - Matt D. O'Connor>: Understood. Fair point. Just separately on the tax rate, last quarter came in low. You called out that gain both at the time and then again today. But today's or the second quarter tax rate seems a little bit higher than at least what we were looking for. What's the outlook? Should we pencil in the 32% going forward?

<A - John R. Shrewsberry>: You should pencil today's effective rate going forward.

<Q - Matt D. O'Connor>: Okay. And then lastly...

<A - John R. Shrewsberry>: It's just not hard.

<Q - Matt D. O'Connor>: Okay. And then just lastly to follow up on earlier question, the mortgage servicing revenue that's coming from the MSR gains, that's going up to MSR because the expenses to service the loans are coming down?

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<A - John R. Shrewsberry>: That's right.

<Q - Matt D. O'Connor>: Okay.

<A - John R. Shrewsberry>: Future cash flows are higher as a result of future expenses coming down – current and future expenses coming down.

<Q - Matt D. O'Connor>: Okay. And is there still – I mean it feels like there's still opportunity to reduce the cost of servicing going forward, which therefore would increase the value of the MSR. And it feels like there's still more of that opportunity there.

<A - John R. Shrewsberry>: There may be. We're probably in the middle innings of perfecting servicing over time. There's still a more elevated level of troubled loans out there compared to what we hope the steady state is years from now. And when that happens it'll be in the future and the benefit of it will be the discounted then future benefit of it. But you're right, it's probably an opportunity at some point in the future.

<Q - Matt D. O'Connor>: Okay. All right. That's helpful. Thank you.

<A - John G. Stumpf>: Thank you.

Operator

Your next question will come from the line of Keith Murray with ISI. Please go ahead with your question.

<Q - Keith E. Murray>: Thanks a lot. Could you spend a minute on cards? So you obviously have increased penetration impressively on the card side. Just a question from penetration to actual usage, how long does it take? And obviously you guys have shown very solid loan growth on the card side but how difficult is it once they get a card from Wells to get them to start using it and kind of move up the pecking order versus other cards?

<A - John G. Stumpf>: Yeah. This is an area that I think is one of our biggest opportunities in the company. If you look at Wells being as we always talk about in the real economy, we have leadership roles in a variety of lending classes whether autos, consumer, small business, real estate, and we are just passionate about helping our retail customers understand the value of having a Wells Fargo card and not only in their wallet but top of wallet.

And there were some areas that we were under-serving especially our affluent and emerging affluent customers. And our partnership with American Express is off to a very good start. Obviously, we do a lot of things with Visa, an important – and MasterCard, partners of ours. But we can sell a card to a customer at a fraction of the cost of someone else from the outside. We know these people better and we can give them better products. We have a lot of exciting benefits that we're giving as part of the card offering.

And it's not only having the balances there, it's being involved with the customer on the payment side. So when we merged the two companies a little over five years ago, Wachovia came without a portfolio because they had sold their card business off. So we were at about a 22% penetration rate. Today we're at 39%. I always tell our people, do you know how many our consumers have credit cards, they all do. In fact they have more than one card. Now, I don't know that we can get to 100% but we are marching smartly up the line. And you're right, it's not only about the number of plastic cards we've issued, it's the ones that are being used. And I'm thrilled with what we're doing. We still have a lot more work to do. Big opportunity for us.

<A - John R. Shrewsberry>: That's right. And it's both in the balances as well as the interchange utilization, and it just works beautifully.

<Q - Keith E. Murray>: Okay. Just switching gears to OLA, you had given us your thoughts on that on Investor Day and obviously you guys issued some long-term debt this quarter. Do you feel like you're getting close to where you're going to wind up needing to be for OLA or any updated thoughts on things you're hearing from Washington on that?

<A - John R. Shrewsberry>: There's no real updated intelligence. We still are hearing and are of a mind that the range that we'll probably be published at some point in the future is in the high teens to low 20%s in terms of loss absorption cushion. We see ourselves on a risk-based approach at the low end of that range and at or within striking distance of that range. So based on everything that we know today, we don't anticipate it having a material impact on Wells Fargo.

<Q - Keith E. Murray>: Okay. And then just finally from me, we've read a lot about the SNC [Shared National Credit] review and regulators' focus on leveraged loans, et cetera. Can you give us any thoughts related to that and any changes you've seen this year in how the regulators are approaching it versus past years?

<A - John R. Shrewsberry>: They're talking about it a lot and there's multiple regulators talking about it a little bit differently. So I think there's an effort to harmonize their points of view, but obviously, they've got a big focus on what's going on with leverage lending inside of banks, and banks mean different things depending on which regulator and which firms they are covering. So I'd anticipate more clarity sometime later this year or maybe beyond that but it really is an effort to understand what's going on and at some level to encourage certain types of behavior and discourage others. And the big emphasis is on the most levered and most collateral free leverage lending. We don't anticipate having an extraordinary impact on Wells Fargo based on our business mix.

<Q - Keith E. Murray>: Got you, thank you.

Operator

Your next question will come from the line of Brian Foran with Autonomous Research. Please go ahead with your question.

<Q - Brian D Foran>: Hi. I was wondering if I could ask about deposit growth in the rising rate scenario and I guess if I oversimplify the two schools of thought or the two ends of the spectrum or deposits have only shrank industry-wide in two of the past 90 years and those were pretty marginal declines. So you can kind of bank on industry deposits growing and then I guess J.P. Morgan was pretty explicit about the other end where they feel like some of the need to drain liquidity out of the system as rates rise could drive deposits down as much as 10%. So I know there's a lot of uncertainty, part of it depends on how the Fed acts, but as you think about liquidity planning and stress testing you do internally, any thoughts on the range of best case and worst case deposit growth you think about?

<A - John G. Stumpf>: Let me just give you an overall how we think about it. I think one of the things that is maybe underappreciated about Wells today is the quality of our deposit franchise. We have $1.1 trillion of deposits at 10 basis points, about $1 trillion of core deposits, and many of these – most of these deposits are what I would call transactional, meaning that people use these deposits either out of their checking account or savings account. We only have $30 million or $40 million of CDs. We have a very high quality deposit base.

We're also growing primary checking accounts. Think about that. The primary account between 4.5% and 5% or lower 5% depending on whether it's small business or consumer, and in fact, these are some of the strongest growth numbers I've ever seen because of the quality of our deposit franchise, the quality of our omni-channel delivery system. And no one knows, of course, we can look back in history what happens with disintermediation about when rates rise and so forth. I'm of the opinion that you're going to see at least for the first couple hundred basis points move up in rates, probably very little movement in disintermediation. You can make the argument that they'll squeeze down M1 and/or M2 and some of the liquidity will come out of the system. We found over time, as you suggested earlier, that deposits generally grow. And it might not grow as fast as it is, but I'm very confident about how our deposit franchise will perform in a rising rate environment.

<Q - Brian D Foran>: That's very helpful. Maybe on the student loan sale, what's your thought process on the decision to sell as opposed to I guess the alternative of just letting it gradually run down over time? Is it a capital free-up or regulatory, or what's the benefit of selling out of it now?

<A - John R. Shrewsberry>: Sure, we had designated the government guaranteed student loan business, which is distinct from our private student loan business that we're very committed to over the long term. We had separated off

the government-guaranteed part of the portfolio into a liquidating portfolio in 2010 when we stopped originating those loans as that market changed. So they've been part of our runoff portfolio for that period of time and amortizing down a little bit. We see the opportunity in the market to move those loans off the books. They're relatively low yielding. They're not strategic. We don't have bigger relationships with most of those customers, and thus the decision. So we've transferred them all to held-for-sale status to signal this intent to sell, and we're going to go about the process in the next quarter or so.

<Q - Brian D Foran>: If I could sneak a last one in on MSR hedging or I guess more specifically the line item you gave of $475 million, the market-related valuation changes net of hedge results. I feel like [indiscernible] (01:01:40). I always set it at zero and then I always end up being too low. It's almost always a positive number. Is that a number that through the cycle you would expect to be a wash, or am I just missing that there is a carry component to it because of the way you structure the hedge and things like that and through the cycle it actually over the past five years has averaged $200 million a quarter and there is a volatile component to it, but through the cycle it should be some positive non-zero number?

<A - John R. Shrewsberry>: It is a carry component. The bundle of instruments that we use to hedge the asset to create the right duration profile as rates move up or down that we think that the value is – change in value is neutralized. That bundle of instruments throws off positive carry. It will depend on the shape or the slope of the yield curve at different points in time. And of course in the past, it's been impacted by other expense items that have been flowing through. There are less of them today, so it's a little bit more standout in terms of its net. And then there's also the influence of what happens when rates speed up or down or prepayment rates speed up or not and of course we've gone through a period recently where the asset has lengthened.

So there are a lot of different things going on there. It's not clear to me what through the cycle actually means in this context because, as rates move, you're in different places. And as the shape of the curve moves you're in different places that are different than a business cycle or a credit cycle. But you can look at the performance over some period of time and set whatever average you think is right. But I think zeroing it out is probably conservative.

<Q - Brian D Foran>: That's very helpful, thank you.

<A - John G. Stumpf>: Thank you.

Operator

Your next question will come from the line of Moshe Orenbuch with Credit Suisse. Please go ahead with your question.

<Q - Moshe A. Orenbuch>: Great, thanks. Most of my questions have actually been asked and answered. But one quick thing is that you've taken a big step up in capital return. Just talk a little bit about what might influence you to go to the very high end of your range or to the lower end of your range in subsequent periods.

<A - John R. Shrewsberry>: So we're setting our expectations and our levels internally from one CCAR process to the next based on how we anticipate that we're going to earn and the negotiation, if you will, that we're having with regulators, which is part of what constructs the balance between dividend and repurchase. And if you think about an annual payout or if we thought about an annual payout based on the annual number, it would be a calculated number in that range. From quarter to quarter, as I mentioned earlier, with respect to what happened to share count, we've got different things going on with share issuance so that the net buyback will be bigger in some quarters than it is in others, which is going to make us look like we're bouncing around inside the range. And that's the reason for moving around inside the range.

Now more importantly, if growth opportunities began to emerge in a more meaningful way where we needed to retain more capital to put it to work, then that would also be a driver. I think at Investor Day, you'll probably recall that Paul Ackerman went through an analysis of the amount of capital that we thought was appropriate to set aside for asset growth and that's the amount of earnings necessary or available to distribute. So that's the starting process.

<Q - Moshe A. Orenbuch>: As a follow-up to that, any thoughts on kind of portfolio acquisition opportunities in the current environment and anything standing out?

<A - John R. Shrewsberry>: I wouldn't say anything standing out. We're out there looking in both consumer and commercial and commercial real estate assets. I mentioned in the loan growth context that we've done a couple of commercial real estate acquisitions. These are all announced that have happened in the quarter – pardon me; that have happened in previous quarters. So we're looking at those. We've talked about card programs like the Dillard's program, where we will be picking up a portfolio of receivables in addition to managing that card program going forward. There's more opportunity there. So we're looking at lots of things. Some things make more sense than others but that's an interesting way for us to add both assets and new customers to the bank.

<Q - Moshe A. Orenbuch>: Got you, very last thing just on that sale, just two quick questions. Do you think you'll sell it in one piece, or do you think you'd break it up into pieces? And do you service that portfolio?

<A - John R. Shrewsberry>: With respect to the first half of the question, it depends. We'd be willing to sell it in one piece. It is a big number, so it may happen in component pieces. And on the second half, we do not service those loans.

<Q - Moshe A. Orenbuch>: Got you, thanks very much.

<A - John G. Stumpf>: Yeah. Thank you.

Operator

Your next question will come from the line of Paul Miller with FBR Capital Markets. Please go ahead with your question.

<Q - Paul J. Miller>: Thank you very much. On the mortgage production side, the $47 billion that you guys produced, how much did you sell into the MBS market and how much did you portfolio?

<A - John R. Shrewsberry>: I don't have that number handy. I think the lion's share of that was sold.

<Q - Paul J. Miller>: Okay. And do you have handy with you what was jumbo?

<A - John R. Shrewsberry>: About $8 billion. Non-conforming mortgages increased $8 billion to about $96 billion.

<Q - Paul J. Miller>: And my guess is you portfolioed all these non-conforming jumbos?

<A - John R. Shrewsberry>: That's correct. My...

<Q - Paul J. Miller>: And...

<A - John R. Shrewsberry>: Go ahead.

<Q - Paul J. Miller>: Go ahead.

<A - John R. Shrewsberry>: The question is whether that $8 billion is part of the $47 billion because if it is, then that answers the question of what was sold. So we'll confirm that.

<Q - Paul J. Miller>: Okay. That makes sense given the MBS issuance data that's been out. I don't have June but given May and July I think you probably issued probably somewhere between $33 billion and $35 billion, so that would coincide with some of that. Have you been portfolioing any conforming loans on your residential portfolio, or has it just been non-conforming jumbos?

<A - John G. Stumpf>: Non-conforming...

<Q - Paul J. Miller>: Okay.

<A - John G. Stumpf>: They're not portfolio conforming.

<Q - Paul J. Miller>: And can you talk a little bit about the pricing of the jumbos? Are they 4.25% – 4.50%? Are they mainly 7/1 – 10/1? Are you portfolioing any 30-year?

<A - John R. Shrewsberry>: So it's a mix of 5/1, 7/1, 10/1, and 30-year, and they're priced for their point on the curve.

<Q - Paul J. Miller>: Okay. Hey, guys. Thank you very much.

<A - John R. Shrewsberry>: You're welcome.

<A - John G. Stumpf>: Thank you.

Operator

Your next question will come from the line of Chris Mutascio with KBW. Please go ahead with your question.

<Q - Chris M. Mutascio>: Good morning, John and John. How are you?

<A - John G. Stumpf>: Hey, Chris.

<A - John R. Shrewsberry>: Hey, Chris.

<Q - Chris M. Mutascio>: As a happy Wells Fargo deposit customer I got a letter in the mail several weeks ago and I wanted to get your thoughts on it. It was changing overdraft, no longer going from processing it from a high to low but going now to first received. I thought that already happened. I guess I was wrong. So I guess my question is, will this have an impact on deposit service charges going forward with the change in the overdraft processing?

<A - John G. Stumpf>: It's not going to be meaningful, no.

<Q - Chris M. Mutascio>: Okay. But has it happened in certain parts of the country because I'm here in Baltimore, Maryland. It's an old Wachovia franchise. Has it happened in certain parts of the country; in other words, the shift to first received and now we're converting other parts of the country, or this is throughout the whole franchise?

<A - John G. Stumpf>: Repeat that one. This is really as a process, we were able to – with debit we are able to do it on a real-time basis. And it was more incorporating that into that hierarchy with checks to get them synchronized. And that was the reason for making that change.

<Q - Chris M. Mutascio>: Okay. So again, the end result of that, this doesn't any impact to deposit service charges going forward?

<A - John G. Stumpf>: It's not going to be meaningful.

<Q - Chris M. Mutascio>: Okay, all right. Thank you.

Operator

Your next question will come from the line of Nancy Bush with NAB Research LLC. Please go ahead with your question.

<Q - Nancy Avans Bush>: Good morning, guys.

<A - John G. Stumpf>: Good morning, Nancy.

<Q - Nancy Avans Bush>: Question about the spring survey from the OCC where they made some fairly pointed comments about deterioration in credit quality, not only in leverage lending, I think there was sort of a loosening of loan standards. I mean there were a whole bunch of sort of bullet points that were somewhat alarming from a credit

quality standpoint. Do you guys see that this is an inflection point in credit quality and do you feel or are you feeling increased pressure to may be start building reserves rather than continuing to let them draw down?

<A - John R. Shrewsberry>: So at least two different questions there. The first part on the competitive environment for loans, and it is a more competitive environment. There are lots of people out there, lots of banks out there with a lot of liquidity competing for loans and we do see more competitive, more borrower-friendly structures that we have to react to from one asset category to another. Now in some like in mortgage, for example, part of it is just getting more clarity on what the rules are and what's going to work and what salable to agencies and things like that. And for other types of assets, we've mentioned the auto earlier, there are people out there who for example are extending the terms on auto loan to lengths that...

<Q - Nancy Avans Bush>: Right.

<A - John R. Shrewsberry>: ...we might not have seen in the past. And of course where all leverage lending is probably the most visible because it's pretty easy to measure the aggressiveness based on leverage multiple, for example. So those things are happening. Our front-line relationship managers and others are confronted with having to make decisions about where we want to be and where we don't want to be. We think we're very good at spotting that and managing credit risk has been a strength of Wells Fargo, as you know, for a very long time.

With respect to reserving, we are looking at our allowance for credit losses every quarter and it reflects and its change reflects what's going on in the portfolio and it's a bottoms-up analysis of what's in the portfolio, what it looks like, what its risk rated, how it's performing, and what our expectation is for near-term credit losses. And as we said here, we anticipate reserve releases declining over some period of time in part to reflect – from 35 basis points it's hard to argue that it can get much better from there. We're sort of bounded by zero on one side and it would expect to gravitate more toward some, whatever normalize means, but some higher level of net charge-offs.

So that's going on, on the one hand, and then there is portfolio growth. As we've said we've had a lot of new loans put on, and all things being equal at some point, our reserve will have to grow to reflect the increased loan balances, which we think is a great thing because we want those loans on the books serving customers, earning interest, and creating the environment to cross sell those customers. So that's how I see that.

<Q - Nancy Avans Bush>: Do you think you'll have an ability to sort of telegraph the change that will actually happen when you have to start building reserves because my guess is that the industry is going to be, or Wall Street, is going to be somewhat shocked when that starts to happen?

<A - John R. Shrewsberry>: As I look at the industry data for what's going on with reserve releases from other banks, they'd been trending and have begun to trend with a few exceptions back up towards zero. So I think people see that coming and it's a reflection of asset growth on the one hand, which is a good thing, and then of course the big reserves that were put on in the heat of the crisis that in some cases were more than what was necessary. But we look at it quarter by quarter just to be clear. This is a GAAP exercise. We've built it up based on what's actually in the portfolio and the experience that we're managing. As you've seen in the data right now, our allowance for credit loss is pushing five times what our actual charge-off experience is right now.

<Q - Nancy Avans Bush>: All right, thank you.

<A - John R. Shrewsberry>: You're welcome.

<A - John G. Stumpf>: Thank you, Nancy.

Operator

Our final question will come from the line of Andrew Marquardt with Evercore. Please go ahead with your question.

<Q - Andrew Marquardt>: Good morning, guys. Thanks. Just a couple of follow-ups here. Just to be clear on the line of questioning from Nancy on credit quality, so it feels like to your point maybe it's hard to get much better than 35

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basis points in aggregate and recovery seems to be less robust and maybe it's very modest uptick in C&I. Like how should we think about the level, should we think about it in this very low range for a period of time and we're still very far from what you've previously deemed as normalized, 75 basis points to 85 basis points, how should we think about that near-term?

<A - John R. Shrewsberry>: Well, I think it's going to be hard for the 35 basis points to move rapidly to any much higher number. And we know what kind of assets we've been putting on the books for the last few years, which I think we all believe are of very high credit quality, particularly on a historical basis. So normalization will happen over some period of time, but at least from our perspective we wouldn't expect it to be an abrupt move. Credit is still going strong.

<Q - Andrew Marquardt>: Okay, got it. And then just a little ticky-tack on the reserving, so not only for the loan growth that's picking up and relief from legacy issues for the industry, there's also this upcoming change in accounting at some point. Any update or thoughts on the CECL coming through and when one might need to start thinking about that for the industry in general?

<A - John R. Shrewsberry>: So what we know about that is that it sounds like it's going to happen. It's not final but we're going to be hearing about it from the FASB in the coming quarters. And at least the way I read it, there's not going to be much of an opportunity to change anyone's mind. And, of course, for anybody who isn't clued into this, this is life of – essentially life of loan reserving. The expectation – our expectation is that that would begin to phase-in in the 2017 timeframe or later. And so it's not really today's issue. And just for the avoidance of doubt, our reserving practices today do not reflect that future contemplated life of preserving – life of loan loss approach. So it's out there. Let's call it 2017 plus and something we're all going to have to figure out how to adapt to.

<Q - Andrew Marquardt>: Great. That's helpful. And then lastly just following on the balance sheet dynamic questions and the NIM optics and issues around deposits, so can you maybe just re-clarify in terms of deposit velocity in a higher rate environment that Brian had brought up earlier? Do you if at all consider kind of re-fencing 5%, 10%, 15% of deposits may be at risk of reversing in a higher rate environment, as some institutions have indicated?

<A - John R. Shrewsberry>: I wouldn't say that we – we don't describe it in our own deposit stress testing internally in quite that way. We talk about the types of deposit accounts that we have and we assign what we think are the right level of behaviors to those accounts. And through that we assess what we think the right level of liquidity is to carry and that liquidity comes in the form both of cash and cash equivalents, which are extraordinary at Wells Fargo today as well as our securities, our relatively liquid securities portfolio that we in a pinch would consider to be salable or financeable. And answering a slightly different question, the sum of those two things is such a significant part of our balance sheet today that it seems like ample coverage for whatever portion of deposits might be, might unexpectedly retract or disappear in the event of the move-up.

<A - John G. Stumpf>: In fact, I think as I mentioned before I think we're going to – our deposit franchise will outperform competitors because of the nature of the kind of deposits we have and the amount of core deposits, especially the amount of retail core. And I think there's going to be a surprise. I think we'll surprise ourselves on how well it's going to do.

<A - John R. Shrewsberry>: That's right. We have – the relationship that we have with our deposit customers is cemented by the tools that we have that we use, that the products that we offer them that allow them to manage their money. So whether it's a consumer or a business customer, we've got the best-in-class interface that allows them – and frankly is hard to move away from in terms of moving money, analyzing money, investing money, et cetera. The mobile convenience, the online convenience, what we've referred to as this omni-channel relationship. It's not easy or convenient to want to change that. So something really has to be compelling about an individual depositor's circumstances or we would have to really be tone deaf to what deposit pricing needs to do in order to retain our balances. So we feel really good about that.

<Q - Andrew Marquardt>: Thanks. That's helpful. And then just if you don't mind, just in terms of – you've mentioned a couple of quarters now how you've had this great continued growth in core deposits but it's optically impacted the NIM but hasn't really negatively impacted the NII. Would a kind of a similar dynamic be envisioned in a

higher rate environment if in fact the velocity was greater than one envisioned in terms of it could go the other way and you could have an optically better net interest margin but the NII could remain relatively stable despite all that? Or how should we think about that? Or how do you think about that?

<A - John R. Shrewsberry>: We don't think about that.

<A - John G. Stumpf>: What's happened in the past is – typically what happens is that the marginal increase and net interest income increase because assets will reprice faster than liabilities will. So maybe – but again that's hypothetical. We'll wait and see what happens at the time.

<Q - Andrew Marquardt>: Got it, great. Thank you, guys.

John G. Stumpf

All right, thank you much, everybody. We appreciate your interest in Wells Fargo. Thank you for joining the call. Excellent questions, and we will see you next quarter. Thank you very much.

Operator

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

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