

Wells Fargo

2Q13 10-Q Review: PAA Yield Upped

New/forward-looking disclosures from WFC's 2Q13 10-Q include:

EPS: The accretible yield balance increased \$2.1bn to \$20.0bn during 2Q from the reclassification from the nonaccretible difference and an increase in cash flows to be collected. As such, the accretible yield is expected to be 4.98%, up 28bps. WFC targets an efficiency ratio of 55-59% (57.3% in 2Q). Mortgage apps increased slightly in 2Q (+\$6bn), but its unclosed pipeline declined (-\$11bn). It expects loan loss reserve releases to continue. It does not currently plan to hold conforming mortgages.

Legal: At 2Q, the high end of possible losses above its mortgage repurchase reserve was \$2.2bn (same as 1Q), on top of its \$2.2bn (-\$0.1bn) reserve. It has observed a decrease in demand for private label repurchase demands. The high end of possible losses above its legal reserve was \$1.1bn (unch'd). On Aug. 5, a California district court found against WFC regarding ordering posting litigation for the amount of \$203mn in *Gutierrez vs. Wells Fargo Bank NA*.

Capital: Based on its current interpretation of the Fed's Basel III NPR, WFC estimates its Tier 1 common ratio at 8.62% (8.39% at 1Q). It believes its supplementary leverage ratios at the BHC and deposit sub exceed the 5% and 6% threshold set by U.S. regulators under the July 2013 proposals. Since 2Q13, it has issued \$2.5bn of senior notes. In July, it entered into a \$500mn accelerated share repurchase (0.2%) that expires in 3Q. In 2Q, it repurchased 26.7mn shares, or 0.5% of outstanding, for \$1.1bn. Its share count rose modestly in 2Q (+0.1%).

Rates: Its EPS at risk was less than 1% (same as 1Q) due to change in rates. Unrealized AFS debt gains were \$4.5bn (\$10.7bn at 1Q), while equity gains were \$458mn (\$516mn at 1Q). The weighted-average expected remaining maturity of the debt securities within its AFS book was 6.7yrs, up from 6.2yrs at 1Q.

WFC: Quarterly and Annual EPS (USD)

	2012		2013		2014		Change y/y		
FY Dec	Actual	Old	New	Cons	Old	New	Cons	2013	2014
Q1	0.75A	0.92A	0.92A	0.92A	N/A	N/A	0.93E	23%	N/A
Q2	0.82A	0.98A	0.98A	0.98A	N/A	N/A	1.00E	20%	N/A
Q3	0.88A	0.97E	0.97E	0.97E	N/A	N/A	1.03E	10%	N/A
Q4	0.91A	0.98E	0.98E	0.98E	N/A	N/A	1.06E	8%	N/A
Year	3.36A	3.85E	3.85E	3.84E	3.95E	3.95E	4.02E	15%	3%
P/E	13.1		11.4			11.1			

Source: Barclays Research.

Consensus numbers are from Thomson Reuters

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PLEASE SEE ANALYST(S) CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 15.

Stock Rating

OVERWEIGHT

Unchanged

Industry View

POSITIVE

Unchanged

Price Target

USD 48.00

Unchanged

Price (06-Aug-2013)	USD 44.03
Potential Upside/Downside	+9%
Tickers	WFC

Market Cap (USD mn)	233295
Shares Outstanding (mn)	5296.40
Free Float (%)	99.86
52 Wk Avg Daily Volume (mn)	21.7
Dividend Yield (%)	2.2
Return on Equity TTM (%)	12.89
Current BVPS (USD)	27.92

Source: FactSet Fundamentals

Price Performance	Exchange-NYSE
52 Week range	USD 44.79-31.25



[Link to Barclays Live for interactive charting](#)

U.S. Large-Cap Banks

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U.S. Large-Cap Banks	Industry View: POSITIVE
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Wells Fargo (WFC)	Stock Rating: OVERWEIGHT
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Income statement (\$mn)	2012A	2013E	2014E	2015E	CAGR
Net interest income	43,932.0	43,961.1	46,089.9	48,778.7	3.5%
Operating expenses	48,225	48,249	49,106	50,723	1.7%
Pre-provision earnings	37,206	37,268	39,286	41,640	3.8%
Loan loss provisions	7,217	3,810	5,511	7,390	0.8%
Pre-tax income	28,471	32,648	32,817	33,354	5.4%
Net income (adj)	17,999	20,610	20,740	21,101	5.4%

Price (06-Aug-2013)	USD 44.03
Price Target	USD 48.00

Why Overweight? WFC benefits from a talented management team, diversified business mix, and a retail deposit base that helps drive the highest NIM amongst its U.S. large-cap peers. We expect its cross-selling traction to continue as it drives further revenue and expense synergies from its WB acquisition.

Balance sheet (\$bn)	Average				
Total assets	1,423	1,491	1,587	1,655	1,539
Risk-weighted assets	1,078	1,134	1,207	1,259	1,170
Non-performing loans (\$mn)	20,486	17,000	15,300	13,005	16,448
Allowance for loan losses	17	16	14	14	15
Loans	799.6	823.8	865.0	908.2	849.1
Deposits	1,003	1,032	1,083	1,138	1,064
Tier 1 capital	123	133	143	152	138
Tier 1 common capital	109	122	132	141	126
Shareholders' equity	145	153	163	172	158
Tangible common equity	112	121	131	140	126
Loan/deposit ratio (%)	82.4	80.1	80.1	80.1	80.7

Upside case	USD 50.00
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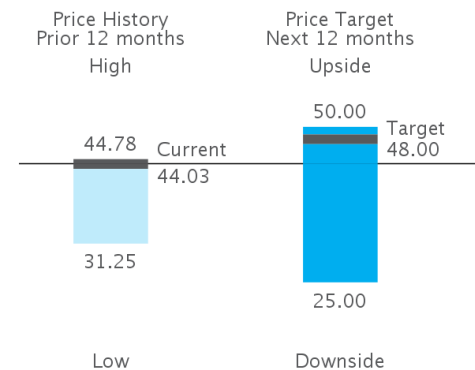
If mortgage banking activity comes in better than the MBA's current forecast and loan growth accelerates from our 4% expectations, it could reach the high-end of its 1.3-1.6% ROA target in 2014. As a result we would expect EPS to exceed \$4.00 and shares to trade to 13x EPS.

Downside case	USD 25.00
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If the U.S. housing market were to experience another 10%-15% decline, we could envision a scenario in which WFC shares trade back down to their 1.3x price to tangible book minimum over the past two years or \$25.00.

Valuation and leverage metrics	Average				
P/E (reported) (x)	13.1	11.4	11.1	10.7	11.6
P/BV (tangible) (x)	2.1	1.9	1.7	1.6	1.8
Dividend yield (%)	2.0	2.6	2.7	2.8	2.5
P/PPE (x)	6.3	6.3	5.9	5.4	6.0
Tier 1 (%)	11.75	11.75	11.83	12.10	11.86
Tier 1 Common (%)	10.12	10.78	10.91	11.23	10.76
Tang assets/tang equity (x)	12.4	12.1	11.9	11.6	12.0

Upside/Downside scenarios

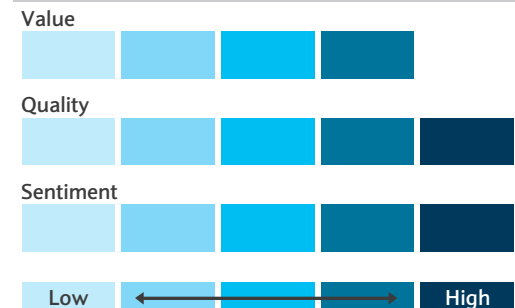


Margin and return data	Average				
Return on RWAs (%)	1.8	1.9	1.8	1.8	1.8
ROA (%)	1.4	1.5	1.4	1.4	1.5
ROE (tangible common) (%)	17.3	18.1	16.9	16.0	17.1
Fee income/revenue (%)	48.6	48.6	47.9	47.2	48.1
Net interest margin (%)	3.8	3.4	3.4	3.4	3.5
Cost/income (%)	56.4	56.4	55.6	54.9	55.8

Credit quality ratios	Average				
Loan loss provs/loans (%)	0.9	0.5	0.6	0.8	0.7
NCO ratio (%)	1.2	0.6	0.8	0.8	0.9
Coverage ratio (%)	83.3	93.4	92.7	111.1	95.1
NPL ratio (%)	2.6	2.1	1.8	1.4	2.0
Reserves/loans (%)	2.1	1.9	1.6	1.6	1.8

Per share data (\$)	Average				
EPS (reported)	3.36	3.85	3.95	4.10	3.82
DPS	0.88	1.15	1.19	1.23	1.11
BVPS (tangible)	21.2	23.0	25.4	27.9	24.4
Payout ratio (%)	26.2	29.9	30.0	30.0	29.0
Diluted shares (mn)	5,350.5	5,356.7	5,249.5	5,144.5	5,275.3

POINT® Quantitative Equity Scores



Source: POINT. The scores are valid as of the date of this report and are independent of the fundamental analysts' views. To view the latest scores, click here.

Source: Company data, Barclays Research
Note: FY End Dec

Forward Looking Statements

- **Mortgage repurchase; The high end of this range of reasonably possible losses in excess of its recorded mortgage repurchase liability was \$2.2bn (\$2.2bn at 1Q13) at 2Q13**, and was determined based upon modifying the assumptions utilized in its best estimate of probable loss to reflect what it believes to be the high end of reasonably possible adverse assumptions.
- **Legal losses:** When establishing a liability for contingent litigation losses, WFC determines a range of potential losses for each matter that is both probable and estimable, and records the amount it considers to be the best estimate within the range. **The high end of the range of reasonably possible potential litigation losses in excess of its liability for probable and estimable losses was \$1.1bn as of 2Q13 (\$1.1bn at 1Q13).**
- **Expenses:** WFC continued to operate within its targeted efficiency ratio range of 55 to 59%, with a ratio of 57.3% in 2Q13.
- **Shares outstanding:** At July 31, 2013, WFC had 5,309,782,331 shares outstanding compared to 5,302,200,000,000 at 2Q13 (+0.1%). In 2Q13, it repurchased 26.7mn shares, or 0.5% of outstanding, for \$1.1bn.
- **CCAR:** On March 14, 2013, it received a non-objection to its 2013 capital plan under the CCAR, which will allow it to return more capital to its shareholders in the year ahead. **The 2013 capital plan included a dividend rate of \$0.30 per share for 2Q13 (+\$0.05), approved by the Board on April 23, and also included an increase in common stock repurchase activity compared with actual repurchases in 2012 (\$4bn).**
- **Forward share repurchase agreement: In April 2013 it entered into a private forward repurchase share repurchase contract and paid \$500mn (0.2% of outstanding) to an unrelated third party.** This contract expires in 3Q13; however, the counterparty has the right to accelerate settlement. **In July 2013 it entered into a similar private forward repurchase contract and paid \$500mn (0.2%) to an unrelated third party.** In return, the counterparty agreed to deliver a variable number of shares based on a per share discount to the volume-weighted average stock price over the contract period. This contract expires in third quarter 2013; however, the counterparty has the right to accelerate settlement.
- **Refinance program:** WFC refinanced 31,000 borrowers with an unpaid principal balance of \$6.7bn under its Refinance Program. Based on the mix of loans it has refinanced, the weighted average note rate was reduced by 260bps and the weighted average estimated remaining life is 10 years. The impact of fulfilling its commitment under the Refinance Program will be recognized over a period of years in the form of lower interest income as qualified borrowers benefit from reduced interest rates on loans refinanced under the Refinance Program. **It expects the future reduction in interest income to be \$1.8bn or \$180mn annually (same as 1Q).** As a result of refinancings under the Refinance Program, it will be forgoing interest that it may not otherwise have agreed to forgo. The estimated reduction of the fair value of our loans for the Refinance Program is approximately \$1.1bn.
- **Reserve Releases: Absent significant deterioration in the economy, it continues to expect future loan loss reserve releases in 2013.**
- **Eurozone exposure:** At 2Q13, foreign loans represented 5% (5% at 1Q13) of its total consolidated loans outstanding and 3% (3%) of its total assets. Its largest foreign country exposure on an ultimate risk basis was the United Kingdom, which amounted to

\$15.7bn, or 1% of its total assets, and included \$2.0bn of sovereign claims. Its United Kingdom sovereign claims arise primarily from deposits it has placed with the Bank of England pursuant to regulatory requirements in support of its London branch. **At 2Q13, its Eurozone exposure, including cross-border claims on an ultimate risk basis, and foreign exchange and derivative products, aggregated to \$10.4bn, including \$200mn of sovereign claims, compared with \$11.1bn at 1Q13, which included \$206mn of sovereign claims.** Its Eurozone exposure is relatively small compared to its overall risk exposure and is diverse by country, type, and counterparty.

- **Cross-sell metrics:** its retail household cross-sell metric stood at 6.14, up from 6.10 at 1Q13. Meanwhile, its commercial cross-sell metric was 6.9 as of 2Q13, up from 6.8 in 2Q12. Credit card penetration in its retail households rose to 34.9% from 34.1% at 1Q13.
- **Intangible asset amortization:** Its amortization expense was \$440mn in 2Q13 and it estimates **\$874mn for the remainder of 2013 (\$437mn quarterly average)**, \$1.58bn for 2014, \$1.44bn for 2015, \$1.29bn for 2016, and \$1.16bn for 2017.
- **Mortgage retention:** During 1H13, it retained for investment **\$3.6bn (\$3.4bn in 1Q13) of 1-4 family conforming first mortgage loans**, forgoing \$120mn of revenue that could have been generated had the loans been originated for sale along with other agency conforming loan production. While retaining these mortgage loans on its balance sheet reduced mortgage revenue, it expects to generate spread income in future quarters from mortgage loans with higher yields than mortgage-backed securities it could have purchased in the market. **While it does not currently plan to hold additional conforming mortgages on balance sheet, it believes it has a large mortgage business and strong capital that provides it with the flexibility to make such choices in the future to benefit its long-term results.**
- **Private label repurchase demands:** WFC believes it has a high quality residential mortgage loan servicing portfolio. Of its \$1.9trn (\$1.9trn at 1Q13) residential mortgage loan servicing portfolio at 2Q13, 93% (93%) was current, less than 2% (2%) was subprime at origination, and less than 1% (~1%) were home equity securitizations. Its combined delinquency and foreclosure rate on this portfolio was 6.65% (6.54% at 1Q13) at 2Q13. **In this portfolio 4% (4% at 1Q13) are private securitizations where it originated the loan and therefore has some repurchase risk. It has observed a decrease in outstanding demands associated with its private label demands.**
- **Accretable yield:** The accretable yield balance increased \$2.1bn to \$20.0bn during 2Q13 as a result of reclassification from the nonaccretable difference and an increase in cash flows expected to be collected. **Due to this increase the accretable yield percentage is expected to be 4.98% in 3Q13, up from 4.70% in 2Q13.**
- **NMS:** As of 2Q13, WFC believes it has successfully executed activities required under both the Consumer Relief (and state-level sub-commitments) and the Refinance Programs in accordance with the terms of its commitments. In its May 14, 2013, submission to the Monitor of the National Mortgage Settlement, it reported \$2.5bn of earned credits toward our Consumer Relief commitment and \$1.7bn of earned credits toward our Refinance Program commitment. It expects its August 14, 2013 submission to the Monitor will include sufficient credits to satisfy the requirements of both programs. Its earned credits are subject to review and approval by the Monitor.

Capital Regulation

- **WFC will be required to comply with the final Basel III capital rules beginning January 2014. Based on its interpretation of the final capital rules, it estimates that**

its Tier 1 common equity ratio under the final Basel III capital rules exceeded the fully phased-in minimum of 7.0% by 162bps at 2Q13. Because the rules were only recently finalized, the interpretations and assumptions it uses in estimating its calculations are subject to change depending on our ongoing review of the final capital rules.

- The final Basel III capital rules did not address the proposed Basel III liquidity standards and also did not address additional capital and leverage requirements that are currently under consideration by the BCBS and U.S. banking regulators. For example, **in July 2013, U.S. banking regulators introduced proposals that would enhance the recently finalized supplemental leverage ratio requirements for large BHCs like WFC and their insured depository institution subsidiaries. Under the proposals, a covered BHC would be required to maintain a supplemental leverage ratio of at least 5% to avoid restrictions on capital distributions and discretionary bonus payments. The proposals would also require that all of its insured depository institution subsidiaries maintain a supplemental leverage ratio of 6% in order to be considered well capitalized. Based on its initial review, it believes its current leverage levels would meet the applicable proposed requirements at the holding company and each of its insured depository institution subsidiaries.** U.S. banking regulators, however, have indicated they may make further changes to the U.S. supplemental leverage ratio requirements based on revisions to the Basel III leverage framework recently proposed by the BCBS.
- As required under the FRB's stress testing rule, WFC completed a mid-cycle stress test based on March 31, 2013 data and scenarios developed by the Company. **It submitted the results of the mid-cycle stress test to the FRB in July 2013 and expects to disclose a summary of the results in September 2013.**

Other Regulation

- **Regulation of interchange transaction fees (Durbin Amendment):** On October 1, 2011, the FRB rule enacted to implement the Durbin Amendment to the Dodd-Frank Act that limits debit card interchange transaction fees to those "reasonable" and "proportional" to the cost of the transaction became effective. The rule generally established that the maximum allowable interchange fee that an issuer may receive or charge for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. **On July 31, 2013, the U.S. District Court for the District of Columbia ruled that the approach used by the FRB in setting the maximum allowable interchange transaction fee impermissibly included costs that were specifically excluded from consideration under the Durbin Amendment. The decision, which may be appealed, keeps in place the current interchange transaction fee standards until the FRB drafts new regulations or interim standards. If the ruling results in the FRB implementing a lower maximum allowable interchange transaction fee, it will have an adverse impact on WFC's debit interchange fee revenue.**
- **Regulation of Swaps and other derivative activity:** The Dodd-Frank Act established a comprehensive framework for regulating over-the-counter derivatives. Included in this framework were certain "push-out" provisions affecting U.S. banks acting as dealers in commodity swaps, equity swaps and certain credit default swaps, which will require that these activities be conducted through an affiliate. The "push-out" provisions in the Dodd-Frank Act provided for an effective date in July 2013, but the provisions granted the OCC the discretion to provide a transition period of up to two years for banks to come into compliance with the requirements. On January 3, 2013, the OCC issued guidance that it would consider transition period requests and favorably act on such

requests subject to the requesting bank meeting specified requirements. WFC prepared and filed a transition period request with the OCC on January 31, 2013. **On June 11, 2013, the OCC granted the request and provided a twenty-four month transition period beginning on July 16, 2013.**

- **Enhanced regulation of money market mutual funds:** In November 2012, the Financial Stability Oversight Council (FSOC) proposed new regulations to address the perceived risks that money market mutual funds may pose to the financial stability of the United States. These proposals included implementation of floating net asset value requirements, redemption holdback provisions, and capital buffer requirements and would be in addition to regulatory changes made by the SEC to the market in January 2010. The proposals were subject to public comment; however, the FSOC has not yet adopted final recommendations. In addition to the proposals under consideration by the FSOC, the SEC proposed rules for public comment on June 5, 2013, that would require a floating net asset value for prime institutional money market funds, allow for the use of liquidity fees and redemption gates during periods of stress, and impose diversification and disclosure requirements.
- **Regulatory capital and leverage requirements:** In July 2013, U.S. banking regulators issued final and interim final rules that substantially amend the risk-based capital rules for banking organizations. The rules implement the Basel III regulatory capital reforms in the U.S., comply with changes required by the Dodd-Frank Act, and replace the existing Basel I-based capital requirements. WFC will be required to comply with the rules beginning January 1, 2014. U.S. banking regulators are also considering proposals that would impose enhanced supplemental leverage ratio requirements on large bank holding companies like WFC and its insured depository institution subsidiaries.
- **Living will requirements:** **On June 29, 2013, WFC submitted its resolution plan to the FRB and FDIC. Resolution planning is mandated by the Dodd-Frank Act** and requires large financial institutions, including WFC, to prepare and periodically revise plans that would facilitate their resolution in the event of material distress or failure. Resolution plans are to provide for a rapid and orderly resolution under the Bankruptcy Code and other insolvency regimes applicable to particular types of entities. Under the regulations, resolution plans must contain strategic analyses of how a distressed or failing institution could be resolved in a way that does not pose systemic risks to the U.S. financial system.

Interest Rates & Balance Sheet

- **At 2Q13, its most recent simulation indicated estimated earnings at risk of less than 1.0% (1.0% at 1Q13) of its most likely earnings plan over the next 24 months** using a scenario in which the federal funds rate increased to 25bps and the 10-year Constant Maturity Treasury bond yield rises to 3.24%.
- **At 2Q13, WFC held \$246.7bn (\$245.4bn at 1Q13) of debt securities in AFS, with net unrealized gains of \$4.5bn vs. \$10.7bn at 1Q13.** It also held \$2.8bn (\$2.8bn at 1Q13) of marketable equity securities AFS at 2Q13, with net unrealized gains of \$458mn (\$516mn at 1Q13). **The weighted-average expected remaining maturity of the debt securities within its AFS portfolio was 6.7 years (6.2 years at 1Q13) at 2Q13.** Because 58% (57% at 1Q13) of this portfolio is MBS, the expected remaining maturity may differ from contractual maturity because borrowers generally have the right to prepay obligations before the underlying mortgages mature. The estimated effect of a 200bp move in interest rates on the fair value of the MBS available for sale securities at 2Q13 was -\$13.6bn (-\$4.8bn at 1Q13) for an increase in rates and +\$7.2bn (+\$10.4bn) for a decrease in rates.

- **At 2Q13, its debt securities available for sale included \$40.9bn (\$40.5bn at 4Q12) of municipal bonds, of which 83% (82%) were rated “A-” or better** based on external, and in some cases internal, ratings. Some of these bonds are guaranteed against loss by bond insurers.
- **WFC has \$8.7bn (\$9.5bn at 1Q13) of securities with losses of \$680mn (\$719mn) at 2Q13 that have been in an unrealized loss position for greater than 12 months**, with CMBS (\$1.7bn fair value, \$131mn of unrealized losses), CDOs (\$396mn, \$50mn unrealized losses) and municipal bonds (\$3.9bn, \$369mn of unrealized losses) accounting for the majority of these losses.
- **Nonmarketable investments of \$17.8bn (\$18.2bn at 1Q13) included private equity investments of \$2.4bn (\$2.5bn at 1Q13) accounted for under the cost method and \$5.7bn (\$6.7bn) of private equity accounted for under the equity method.**
- **At 2Q13, its level 3 assets totaled \$42.5bn (3% of assets; \$41.8bn at 1Q13)**, of which \$16.1bn (\$17.0bn) related to AFS securities and \$14.2bn was MSR (\$12.1bn).

Asset Quality

- **Total loans stood at \$802.0bn (\$799.9bn at 1Q13) at 2Q13.** Its loan mix at 2Q13 was 55% (55% at 1Q13) consumer and 45% (45%) commercial/CRE. Its commercial/CRE categorical mix was commercial 24% of total loans (23% at 1Q13), commercial mortgage 13% (13%), real estate construction 2% (2%), lease financing 1% (2%), and foreign 5% (5%). Its consumer book included residential mortgage 32% (32%), home equity 9% (9%), card 3% (3%) and other 11% (11%). **The carrying value of its net loans of \$768.1bn was lower than the fair value of \$773.3bn by \$5.2bn (0.7%).**
- Nonperforming assets decreased by \$1.8bn to \$21.0bn in 2Q13, with declines in both nonaccrual loans and foreclosed assets.
- **The improvement in its credit portfolio in 2Q13 was due in part to the continued decline in balances in its non-strategic/liquidating loan portfolios, which decreased \$3.3bn linked quarter to \$87.6bn at 2Q13.** These portfolios consist primarily of its Pick-a-Pay mortgage portfolio (\$54.8bn) acquired from WB as well as some portfolios from legacy WFC Home Equity (\$4.2bn) and WFC Financial (\$13.7bn). Effective in 1Q11, it added its education finance government guaranteed loan portfolio (\$11.5bn) to the non-strategic and liquidating portfolios as there is no longer a U.S. Government guaranteed student loan program available to private financial institutions pursuant to legislation in 2010.
- Its real estate 1-4 family mortgage loans to borrowers in California represented 13% of total loans (2% of this amount were PCI loans from WB) at 2Q13, mostly within the larger metropolitan areas, with no single California metropolitan area consisting of more than 3% of total loans. It tracks delinquency, FICO scores and collateral values (LTV/CLTV) on its entire real estate 1-4 family mortgage loan portfolio. These metrics continued to improve in 2Q13 on the non-PCI mortgage portfolio. Loans 30 days or more delinquent at 2Q13, totaled \$13.3bn, or 4%, of total non-PCI mortgages, compared with 5% at 1Q13. Loans with FICO scores lower than 640 totaled \$34.2bn at 2Q13, or 12% of all non-PCI mortgages, compared with \$36.9bn, or 13%, at 1Q13. Mortgages with a LTV/CLTV greater than 100% totaled \$48.7bn at 2Q13, or 16% of total non-PCI mortgages, compared with \$55.8bn, or 19%, at 1Q13.
- Its Pick-a-Pay portfolio was one of the consumer residential first mortgage portfolios it acquired from WB. It considered a majority of the Pick-a-Pay loans to be PCI loans. **Its Pick-a-Pay portfolio had an outstanding balance of \$59.8bn (\$61.8bn at 1Q13) and**

a carrying value of \$54.8bn (\$56.6bn) at 2Q13. It is a liquidating portfolio, as WB ceased originating new Pick-a-Pay loans in 2008. The Pick-a-Pay portfolio includes loans that offer payment options (Pick-a-Pay option payment loans), loans that were originated without the option payment feature, loans that no longer offer the option feature as a result of its modification efforts since the acquisition, and loans where the customer voluntarily converted to a fixed-rate product.

- Due to better than expected performance observed on the Pick-a-Pay portfolio compared with the original acquisition estimates, it has reclassified \$3.0bn from the nonaccretable difference to the accretable yield since acquisition. This performance is primarily attributable to significant modification efforts as well as the portfolio's delinquency stabilization. The resulting increase in the accretable yield will be realized over the remaining life of the portfolio, which is estimated to have a weighted-average remaining life of 14.5 years at 2Q13. **The accretable yield percentage at 2Q13 was 4.70%, unchanged from 1Q13.**
- In 2Q13, it completed more than 2,400 proprietary and HAMP Pick-a-Pay loan modifications and has completed more than 117,000 modifications since the WB acquisition, resulting in \$5.5bn of principal forgiveness to its Pick-a-Pay customers as well as an additional \$331mn of conditional forgiveness that can be earned by borrowers through performance over the next three years.
- Its home equity liquidating portfolio was \$4.2bn at 2Q13, compared with \$4.4bn at 1Q13. The loans in this liquidating portfolio represent less than 1% of its total loans outstanding at 2Q13, and contain some of the highest risk in its \$89.0bn Home Equity portfolio, with a loss rate of 5.05% compared with 1.56% for the core portfolio. The loans in the liquidating portfolio are largely concentrated in geographic markets that have experienced the most abrupt and steepest declines in housing prices. The core portfolio was \$84.8bn (\$87.2bn at 1Q13) at 2Q13. California loans represent the largest state concentration in each of these portfolios and have experienced among the highest early-term delinquency and loss rates. **At 2Q13, 30% (33% at 1Q13) of the outstanding balance of the core home equity portfolio was associated with loans that had a combined loan to value (CLTV) ratio in excess of 100%.**
- Its CRE portfolio consists of CRE mortgage loans and CRE construction loans, totaled \$121.1bn, or 15%, of total loans at 2Q13. CRE construction loans totaled \$16.4bn at 2Q13, and CRE mortgage loans totaled \$104.7bn. CRE nonaccrual loans totaled 2.8% of the non-PCI CRE outstanding balance. The portfolio is diversified both geographically and by property type. **The largest geographic concentrations of combined CRE loans are in California and Florida, which represented 27% and 8% of the total CRE portfolio, respectively.** By property type, the largest concentrations are office buildings at 27% and apartments at 12%. At 2Q13, it had \$15.4bn of criticized non-PCI CRE mortgage loans, down from \$17.2bn at 1Q13, and \$2.8bn of criticized non-PCI CRE construction loans, down from \$3.4bn at 1Q13.
- **Its total troubled debt restructurings (TDRs) at 2Q13 were \$27.5bn (\$4.6bn commercial and \$23.0bn consumer), down slightly from \$27.7bn at 1Q13. Of this amount, \$18.5bn (\$17.4bn at 1Q13) was on accrual status, while \$9.0bn (\$10.3bn) was on nonaccrual.**

Off-Balance Sheet Arrangements

- At 2Q13, WFC had unconsolidated VIEs worth \$45.3bn (\$45.1bn at 1Q13), with total assets of \$1.6trn (\$1.6trn). Its maximum loss exposure related to these entities was \$58.5bn (\$58.1bn at 1Q13) at 2Q13.

- Through the issuance of trust preferred securities it had junior subordinated debt financing with a carrying value of \$2.0bn at 2Q13 and \$2.1bn at 1Q13, as well as \$2.5bn of preferred stock at 2Q13 (same as 1Q13). **In 1H13, it redeemed \$2.8bn of trust preferred securities that will no longer count as Tier 1 capital under the Dodd-Frank Act and the Basel Committee recommendations known as the Basel III standards.**
- During 1H13, the Parent issued \$7.1bn of senior notes, of which \$2.7bn were registered with the SEC. In addition, during 1H13, the Parent issued \$2.0bn of registered subordinated medium term notes. **Since 2Q13, the Parent has issued \$2.5bn of registered senior notes.**
- WFC had outstanding guarantees with carrying values of \$1.3bn (\$1.2bn at 1Q13) and \$59.8bn (\$59.9bn) of maximum loss exposure (including \$35.5bn of standby letters of credit, and \$13.4bn of written put options).
- WFC had net derivative assets of \$16.8bn (\$16.9bn at 1Q13) at 2Q13 and net derivative liabilities of \$10.7bn (\$8.0bn).

Accounting

- ASU 2011-11 expands the disclosure requirements for financial instruments and derivatives that may be offset in accordance with enforceable master netting agreements or similar arrangements. The disclosures are required regardless of whether the instruments have been offset (or netted) in the statement of financial position. Under ASU 2011-11, companies must describe the nature of offsetting arrangements and provide quantitative information about those agreements, including the gross and net amounts of financial instruments that are recognized in the statement of financial position. In January 2013, the FASB issued ASU 2013-01, which clarifies the scope of ASU 2011-11 by limiting the disclosures to derivatives, repurchase agreements, and securities lending transactions to the extent they are subject to an enforceable master netting or similar arrangement. **WFC adopted this guidance in 1Q13 with retrospective application. These Updates did not affect its consolidated financial results since they amend only the disclosure requirements for offsetting financial instruments.**
- ASU 2013-02 requires companies to disclose the effect on net income line items from significant amounts reclassified out of accumulated other comprehensive income and entirely into net income. If reclassifications are partially or entirely capitalized on the balance sheet, then companies must provide a cross-reference to disclosures that provide information about the effect of the reclassifications. **WFC adopted this guidance in 1Q13 with retrospective application. This Update did not affect its consolidated financial results as it amends only the disclosure requirements for accumulated other comprehensive income.**
- During 2Q13, WFC recognized in income \$17mn released from the nonaccretable difference related to commercial PCI loans due to payoffs and other resolutions. It also transferred \$878mn from the nonaccretable difference to the accretable yield for PCI loans with improving credit-related cash flows and absorbed \$152mn of losses in the nonaccretable difference from loan resolutions and write-downs.
- Since 4Q08, it has released \$8.1bn (\$7.2bn at 1Q13) in nonaccretable difference for certain PCI loans and pools of PCI loans, including \$6.3bn (\$5.4bn) transferred from the nonaccretable difference to the accretable yield and \$1.8bn (\$1.8bn) released to income through loan resolutions. It has provided \$1.8bn (\$1.8bn) in the allowance for credit losses for certain PCI loans or pools of PCI loans that have had credit-related decreases

to cash flows expected to be collected. The net result is a \$6.3bn (\$5.4bn at 1Q13) reduction from 4Q08 through 2Q13, in its initial expected losses on all PCI loans.

- **PCI loans had an unpaid principal balance of \$41.4bn (\$43.0bn at 1Q13) at 2Q13, and a carrying value, before the deduction of the allowance for loan losses, of \$28.8bn (\$29.7bn at 2Q13).**
- **PCI-related accretion in 2Q13 totaled \$458mn and had a +14bp impact on its net interest margin.**
- Net gains on debt and equity securities totaled \$149mn for 2Q13 and \$158mn for 1Q13, after other-than-temporary impairment (OTTI) write-downs of \$111mn for 2Q13 and \$78mn for 1Q13.

Mortgage Banking

- Mortgage banking noninterest income, consisting of net servicing income and net gains on loan origination/sales activities, totaled \$2.8bn in 2Q13, compared with \$2.8bn in 1Q13. For 1H13, mortgage banking noninterest income totaled \$5.6bn, down from \$5.8bn in 1H12.
- Net mortgage loan servicing income includes amortization of commercial mortgage servicing rights (MSRs), changes in the fair value of residential MSRs during the period as well as changes in the value of derivatives (economic hedges) used to hedge the residential MSRs. Net servicing income for 2Q13 included a \$68mn net MSR valuation gain (\$1.87bn increase in the fair value of the MSRs offset by a \$1.8bn hedge loss).
- Its portfolio of loans serviced for others was \$1.90trn at 2Q13 and \$1.89trn at 1Q13. The total carrying value of its residential and commercial MSRs was \$15.4bn at 2Q13, and \$13.2bn at 1Q13. The weighted-average note rate on its portfolio of loans serviced for others was 4.59% at 2Q13, and 4.69% at 1Q13. **Its total MSRs represented 0.81% of mortgage loans serviced for others at 2Q13, compared with 0.70% at 1Q13.**
- Income from mortgage loan origination/sale activities was \$2.4bn in 1Q13 compared with \$2.5bn in 1Q13. **Residential real estate originations were \$112bn in 2Q13, compared with \$109bn in 1Q13.**
- **Mortgage applications were \$146bn in 2Q13 (\$140bn in 1Q13). Its 1-4 family first mortgage unclosed pipeline was \$63bn (\$74bn at 1Q13) at 2Q13.**

Reserve For Mortgage Loan Repurchase Losses

- Net gains on mortgage loan origination/sales activities include the cost of any additions to the mortgage repurchase liability. Mortgage loans are repurchased from third parties based on standard representations and warranties, and early payment default clauses in mortgage sale contracts. **Additions to the mortgage repurchase liability that were charged against net gains on mortgage loan origination/sales activities during 2Q13 totaled \$65mn (compared with \$309mn for 1Q13), of which \$25mn was for subsequent increases in estimated losses on prior period loan sales.**
- **Currently, its repurchase demands primarily relate to 2006 through 2008 vintages and to GSE-guaranteed MBS.**
- **During 1H13, it experienced some levelling off in repurchase activity as measured by outstanding repurchase demands.** It repurchased or reimbursed investors for incurred losses on mortgage loans with original balances of \$457mn in 2Q13, compared with \$483mn in 1Q13. It incurred net losses on repurchased loans and investor reimbursements totalling \$160mn in 1Q13, compared with \$198mn in 1Q13.

- The overall level of unresolved repurchase demands and mortgage insurance rescissions outstanding at 1Q13, was down from a year ago in both number of outstanding loans and in total dollar balances as it continued to work through the new demands and mortgage insurance rescissions. Customary with industry practice, it has the right of recourse against correspondent lenders from whom we have purchased loans with respect to representations and warranties. **Of total repurchase demands and mortgage insurance rescissions outstanding as of 2Q13, 25% relate to loans purchased from correspondent lenders.** Due primarily to the financial difficulties of some correspondent lenders, it is currently recovering on average 45% of losses from these lenders. Historical recovery rates as well as projected lender performance are incorporated in the establishment of our mortgage repurchase liability.
- **Its liability for mortgage repurchases, included in “Accrued expenses and other liabilities” in its consolidated balance sheet, was \$2.2bn at 2Q13, \$2.3bn at 1Q13.** In 2Q13, it recorded an additional \$65mn to the liability, which reduced net gains on mortgage loan origination/sales activities, compared with an additional liability of \$309mn in 1Q12. Its provision in 2Q13 reflected an increase for indemnifications and specific private investor demands (comprising approximately 55% of 2Q13 provision) and new loan sales (approximately 45%).
- **The high end of this range of reasonably possible losses in excess of its recorded mortgage repurchase liability was \$2.2bn (\$2.2bn at 1Q13) at 2Q13,** and was determined based upon modifying the assumptions utilized in its best estimate of probable loss to reflect what it believes to be the high end of reasonably possible adverse assumptions.
- **WFC believes it has a high quality residential mortgage loan servicing portfolio.** Of its \$1.9trn (\$1.9trn at 1Q13) residential mortgage loan servicing portfolio at 2Q13, 93% (93%) was current, less than 2% (2%) was subprime at origination, and less than 1% (~1%) were home equity securitizations. Its combined delinquency and foreclosure rate on this portfolio was 6.65% (6.54% at 1Q13) at 2Q13. In this portfolio 4% (4% at 1Q13) are private securitizations where it originated the loan and therefore has some repurchase risk. **It has observed a decrease in outstanding demands, compared to 4Q12, associated with its private label demands.** For this private securitization segment of its residential mortgage loan servicing portfolio, 57% (57% at 1Q13) are loans from 2005 vintages or earlier (weighted average age of 92 months); 77% (78%) were prime at origination and 62% (63%) are jumbo loans. The weighted-average LTV at 2Q13, for this private securitization segment was 69% (74% at 1Q13). It believes the highest risk segment of these private securitizations is the subprime loans originated in 2006 and 2007. These subprime loans have seller representations and warranties and currently have LTVs close to or exceeding 100%, and represent 10% of the 4% private securitization portion of the residential mortgage servicing portfolio. It had only \$12mn of repurchased loans related to private securitizations in 2Q13. Of its servicing portfolio, 3% is non-agency acquired servicing and 1% is private whole loan sales. It did not underwrite and securitize the non-agency acquired servicing and therefore has no obligation on that portion of its servicing portfolio to the investor for any repurchase demands arising from origination practices. For the private whole loan segment, while it does have repurchase risk on these prior loan sales, less than 2% (2% at 1Q13) were subprime at origination and loans that were sold and subsequently securitized are included in its private securitization segment.

Capital/Other

- **Capital ratios:** Its Tier 1 capital ratio stood at 12.12% (12.00% at 1Q13) at 2Q13, its total capital ratio was 15.03% (14.76%), and its leverage ratio stood at 9.63% (9.53%).

Its Tier 1 common ratio increased to 10.71% (10.39%). **Under its interpretation of current Basel III capital proposals, it estimated its Tier 1 common equity ratio at 8.62% (8.39% at 1Q13) at 2Q13.** At 2Q13, WFC and each of its subsidiary banks were “well capitalized” under the applicable regulatory capital adequacy guidelines.

- **Basel II.5:** Effective January 1, 2013, WFC implemented changes to the market risk capital rule, commonly referred to as Basel 2.5, as required by the U.S. banking regulators. Basel 2.5 requires banking organizations with significant trading activities to adjust their capital requirements to better account for the market risks of those activities. **Adoption of the market risk capital rule is reflected in the calculation of risk weighted assets and negatively impacted 2Q13 capital ratios under Basel I by 25bps, but did not impact its ratio under Basel III, as its impact has historically been included in our calculations.**
- **Capital actions:** On March 14, 2013, it received a non-objection to its 2013 capital plan under the CCAR, which will allow it to return more capital to its shareholders in the year ahead. **The 2013 capital plan included a dividend rate of \$0.30 per share for 2Q13, approved by the Board on April 23, 2013, and also included an increase in common stock repurchase activity compared with actual repurchases in 2012 (\$4bn).** In 2Q13, it repurchased 26.7mn shares, or 0.5% of outstanding, for \$1.1bn.
- **Forward share repurchase agreement: In April 2013 it entered into a private forward repurchase share repurchase contract and paid \$500mn (0.2% of outstanding) to an unrelated third party.** This contract expires in 3Q13; however, the counterparty has the right to accelerate settlement. **In July 2013 it entered into a similar private forward repurchase contract and paid \$500mn (0.2%) to an unrelated third party.** In return, the counterparty agreed to deliver a variable number of shares based on a per share discount to the volume-weighted average stock price over the contract period. This contract expires in third quarter 2013; however, the counterparty has the right to accelerate settlement.
- **Deposits:** About 94% of its average core deposits are in checking and savings deposits, one of the highest percentages in the industry.
- **Trust and brokerage balances:** It earns trust, investment and IRA (Individual Retirement Account) fees from managing and administering assets, including mutual funds, corporate trust, personal trust, employee benefit trust and agency assets. These assets totaled \$2.1trn (\$2.3trn at 1Q13) at 2Q13. Brokerage client assets totaled \$1.3trn (\$1.3trn at 1Q13) at 2Q13. Its trust, investment and IRA fees are largely based on a tiered scale relative to the market value of the assets under management or administration. These fees increased totaled \$829mn in 2Q13 from \$799mn in 1Q13. It earns investment banking fees from underwriting debt and equity securities, loan syndications, and performing other related advisory services. Investment banking fees increased to \$538mn in 2Q13 from \$353mn in 1Q13, primarily driven by increased loan syndication volume.
- **Trading activities: Net gains from trading activities, which reflect unrealized changes in fair value of its trading positions and realized gains and losses, were \$331mn in 2Q13 compared with \$570mn in 1Q13.** The y/y decrease was driven by lower gains on deferred compensation plan investments (offset in employee benefits expense) and lower hedging gains. Net gains (losses) from trading activities do not include interest and dividend income on trading securities. Those amounts are reported within net interest income from trading assets. **Proprietary trading generated \$4mn of net gains in 2Q13 and \$4mn of net gains in 1Q13. Proprietary trading results also included interest and fees reported in their corresponding income statement line**

items. Proprietary trading activities are not significant to its client-focused business model.

- **Earnings mix:** In 2Q13, its revenue mix (ex. other) was 58% community banking, 27% wholesale banking and 15% wealth, brokerage & retirement.
- **Value-at-risk (VaR):** Its average one-day VaR throughout 2Q13 was \$15mn.

Legal

- When establishing a liability for contingent litigation losses, WFC determines a range of potential losses for each matter that is both probable and estimable, and records the amount it considers to be the best estimate within the range. **The high end of the range of reasonably possible potential litigation losses in excess of its liability for probable and estimable losses was \$1.1bn as of 2Q13 (\$1.1bn at 1Q13).**
- **Medical Capital Litigation** Wells Fargo Bank, N.A. served as indenture trustee for debt issued by affiliates of Medical Capital Corporation, which was placed in receivership at the request of the Securities and Exchange Commission (SEC) in August 2009. Since September 2009, Wells Fargo has been named as a defendant in various class and mass actions brought by holders of Medical Capital Corporation's debt, alleging that Wells Fargo breached contractual and other legal obligations owed to them and seeking unspecified damages. **On April 16, 2013, the parties reached a settlement, subject to Court approval, of all claims which provides for WFC to pay \$105mn to the plaintiffs. The Court gave preliminary approval to the settlement on May 6, 2013.**
- **Maryland mortgage lending litigation:** On December 26, 2007, a class action complaint captioned *Denise Minter, et al., v. Wells Fargo Bank, N.A., et al.*, was filed in the U.S. District Court for the District of Maryland. The complaint alleges that Wells Fargo and others violated provisions of the Real Estate Settlement Procedures Act and other laws by conducting mortgage lending business improperly through a general partnership, Prosperity Mortgage Company. The complaint asserts that Prosperity Mortgage Company was not a legitimate affiliated business and instead operated to conceal Wells Fargo Bank, N.A.'s role in the loans at issue. A plaintiff class of borrowers who received a mortgage loan from Prosperity Mortgage Company that was funded by Prosperity Mortgage Company's line of credit with Wells Fargo Bank, N.A. from 1993 to May 31, 2012, had been certified. Prior to trial, the Court narrowed the class action to borrowers who were referred to Prosperity Mortgage Company by Wells Fargo's partner and whose loans were transferred to Wells Fargo Bank, N.A. from 1993 to May 31, 2012. **On May 6, 2013, the case went to trial. On June 6, 2013, the jury returned a verdict in favor of all defendants, including WFC. The plaintiffs have requested a new trial on the named plaintiffs' individual claims, and have filed a notice of appeal.**
- **Order positing litigation:** A series of putative class actions have been filed against Wachovia Bank, N.A. and Wells Fargo Bank, N.A., as well as many other banks, challenging the high to low order in which the banks post debit card transactions to consumer deposit accounts. There are currently several such cases pending against Wells Fargo Bank (including the Wachovia Bank cases to which Wells Fargo succeeded), most of which have been consolidated in multi-district litigation proceedings in the U.S. District Court for the Southern District of Florida. The bank defendants moved to compel these cases to arbitration under recent Supreme Court authority. On November 22, 2011, the Judge denied the motion. The bank defendants appealed the decision to the U.S. Court of Appeals for the Eleventh Circuit. On October 26, 2012, the Eleventh Circuit affirmed the District Court's denial of the motion. Wells Fargo renewed its motion to compel arbitration with respect to the unnamed putative class members. On April 8,

2013, the District Court denied the motion. WFC has appealed the decision to the Eleventh Circuit. On August 10, 2010, the U.S. District Court for the Northern District of California issued an order in *Gutierrez v. Wells Fargo Bank, N.A.*, a case that was not consolidated in the multi-district proceedings, enjoining WFC's use of the high to low posting method for debit card transactions with respect to the plaintiff class of California depositors, directing the bank to establish a different posting methodology and ordering remediation of approximately \$203mn. On October 26, 2010, a final judgment was entered in *Gutierrez*. On October 28, 2010, WFC appealed to the U.S. Court of Appeals for the Ninth Circuit. On December 26, 2012, the Ninth Circuit reversed the order requiring WFC to change its order of posting and vacated the portion of the order granting remediation of approximately \$203mn on the grounds of federal preemption. The Ninth Circuit affirmed the District Court's finding that WFC violated a California state law prohibition on fraudulent representations and remanded the case to the District Court for further proceedings. **On May 14, 2013, the District Court entered an order indicating it will reinstate the judgment of approximately \$203mn against WFC and enjoined WFC from making or disseminating additional misrepresentations about its order of posting of transactions. WFC has appealed the order to the Ninth Circuit. On August 5, 2013, the District Court entered a judgment against WFC in the approximate amount of \$203mn, together with post-judgment interest thereon from October 25, 2010.**

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I, Jason M. Goldberg, CFA, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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Primary Stocks (Ticker, Date, Price)

Wells Fargo (WFC, 06-Aug-2013, USD 44.03), Overweight/Positive, A/C/D/F/J/K/L/M/N/O

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KeyCorp (KEY)	Northern Trust (NTRS)	PNC Financial Services Gp (PNC)
Regions Financial (RF)	State Street (STT)	SunTrust Banks (STI)
The Bank of New York Mellon Corp. (BK)	U.S. Bancorp (USB)	Wells Fargo (WFC)

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IMPORTANT DISCLOSURES CONTINUED

Wells Fargo (WFC)
USD 44.03 (06-Aug-2013)

Stock Rating
OVERWEIGHT

Industry View
POSITIVE

Rating and Price Target Chart - USD (as of 06-Aug-2013)

Currency=USD



Date	Closing Price	Rating *	Price Target
15-Jul-2013	43.35		48.00
15-Apr-2013	36.57		45.00
16-Apr-2012	33.15		42.00
18-Jan-2012	30.24		39.00
18-Oct-2011	25.86		36.00
20-Jul-2011	28.70		38.00

*The rating for this security remained Overweight during the relevant period.

[Link to Barclays Live for interactive charting](#)

A: Barclays Bank PLC and/or an affiliate has been lead manager or co-lead manager of a publicly disclosed offer of securities of Wells Fargo in the previous 12 months.

C: Barclays Bank PLC and/or an affiliate is a market-maker and/or liquidity provider in securities issued by Wells Fargo or one of its affiliates.

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Valuation Methodology: Our price target of \$48 is based on our DCF and ROIC models and implies an 12x multiple on our 2014 EPS estimate of \$3.95.

Risks which May Impede the Achievement of the Barclays Research Price Target: Deterioration in the California economy; negative legislative decision(s); an increase in the cost of doing business in California; Increased political scrutiny/risk; ineffective mortgage banking hedges.

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