WELLS FARGO & CO/MN
Form 10-Q
November 06, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2009
Commission file number 001-2979

WELLS FARGO & COMPANY
(Exact name of registrant as specified in its charter)

Delaware	No. 41-0449260
(State of incorporation)	(I.R.S. Employer Identification No.)

420 Montgomery Street, San Francisco, California 94163
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: 1-866-249-3302

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ	Accelerated filer o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

	Shares Outstanding October 30, 2009
Common stock, $1-2/3 par value	4,685,063,588

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PART I FINANCIAL INFORMATION
FINANCIAL REVIEW
SUMMARY FINANCIAL DATA (1)(2)

($ in millions, except per share amounts)	**Sept. 30, 2009**	Quarter ended June 30, 2009	Sept. 30, 2008	Nine months ended **Sept. 30, 2009**	Sept. 30, 2008
For the Period					
Wells Fargo net income	**$ 3,235**	3,172	1,637	**9,452**	5,389
Wells Fargo net income applicable to common stock	**2,637**	2,575	1,637	**7,596**	5,389
Diluted earnings per common share	**0.56**	0.57	0.49	**1.69**	1.62
Profitability ratios (annualized):					
Wells Fargo net income to average assets (ROA)	**1.03%**	1.00	1.06	**1.00**	1.21
Net income to average assets	**1.06**	1.02	1.07	**1.02**	1.22
Wells Fargo net income applicable to common stock to average Wells Fargo common stockholders equity (ROE)	**12.04**	13.70	13.63	**13.29**	15.02
Net income to average total equity	**10.57**	11.56	13.66	**11.32**	15.06
Efficiency ratio (3)	**52.0**	56.4	53.0	**54.9**	51.8
Total revenue	**$ 22,466**	22,507	10,377	**65,990**	32,400
Pre-tax pre-provision profit (PTPP) (4)	**10,782**	9,810	4,876	**29,791**	15,612
Dividends declared per common share	**0.05**	0.05	0.34	**0.44**	0.96
Average common shares outstanding	**4,678.3**	4,483.1	3,316.4	**4,471.2**	3,309.6
Diluted average common shares outstanding	**4,706.4**	4,501.6	3,331.0	**4,485.3**	3,323.4
Average loans	**$ 810,191**	833,945	404,203	**833,076**	393,262
Average assets	**1,246,051**	1,274,926	614,194	**1,270,071**	594,717
Average core deposits (5)	**759,319**	765,697	320,074	**759,668**	318,582
Average retail core deposits (6)	**584,414**	596,648	234,140	**590,499**	230,935
Net interest margin	**4.36%**	4.30	4.79	**4.27**	4.80
At Period End					
Securities available for sale	**$ 183,814**	206,795	86,882	**183,814**	86,882
Loans	**799,952**	821,614	411,049	**799,952**	411,049
Allowance for loan losses	**24,028**	23,035	7,865	**24,028**	7,865
Goodwill	**24,052**	24,619	13,520	**24,052**	13,520
Assets	**1,228,625**	1,284,176	622,361	**1,228,625**	622,361
Core deposits (5)	**747,913**	761,122	334,076	**747,913**	334,076

Wells Fargo stockholders equity	**122,150**	114,623	46,957	**122,150**	46,957
Total equity	**128,924**	121,382	47,259	**128,924**	47,259
Tier 1 capital (7)	**108,785**	102,721	45,182	**108,785**	45,182
Total capital (7)	**150,079**	144,984	60,525	**150,079**	60,525
Capital ratios:					
Wells Fargo common stockholders equity to assets	**7.41%**	6.51	7.54	**7.41**	7.54
Total equity to assets	**10.49**	9.45	7.59	**10.49**	7.59
Average Wells Fargo common stockholders equity to average assets	**6.98**	5.92	7.78	**6.02**	8.06
Average total equity to average assets	**9.99**	8.85	7.83	**8.98**	8.11
Risk-based capital (7)					
Tier 1 capital	**10.63**	9.80	8.59	**10.63**	8.59
Total capital	**14.66**	13.84	11.51	**14.66**	11.51
Tier 1 leverage (7)	**9.03**	8.32	7.54	**9.03**	7.54
Book value per common share	**$ 19.46**	17.91	14.14	**19.46**	14.14
Team members (active, full-time equivalent)	**265,100**	269,900	159,000	**265,100**	159,000
Common stock price:					
High	**$ 29.56**	28.45	44.68	**30.47**	44.68
Low	**22.08**	13.65	20.46	**7.80**	20.46
Period end	**28.18**	24.26	37.53	**28.18**	37.53

(1) Wells Fargo & Company (Wells Fargo) acquired Wachovia Corporation (Wachovia) on December 31, 2008. Because the acquisition was completed on December 31, 2008, Wachovia s results are included in the income statement, average balances and related metrics beginning in 2009. Wachovia s assets and liabilities are included in the consolidated balance sheet beginning on December 31, 2008.

(2) On January 1, 2009, we adopted new accounting guidance on noncontrolling interests on a retrospective basis for disclosure and, accordingly, prior period information reflects the adoption. The guidance requires that noncontrolling interests be reported as a component of total equity.

(3) The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income).

(4) Pre-tax pre-provision profit (PTPP) is total revenue less noninterest expense. Management believes that PTPP is a useful financial measure because it enables investors and others to assess the Company s ability to generate capital to cover credit losses through a credit cycle.

(5) Core deposits are noninterest-bearing deposits, interest-bearing checking, savings

certificates, market rate and other savings, and certain foreign deposits (Eurodollar sweep balances).

(6) Retail core deposits are total core deposits excluding Wholesale Banking core deposits and retail mortgage escrow deposits.

(7) See Note 18 (Regulatory and Agency Capital Requirements) to Financial Statements in this Report for additional information.

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This Report on Form 10-Q for the quarter ended September 30, 2009, including the Financial Review and the Financial Statements and related Notes, has forward-looking statements, which may include forecasts of our financial results and condition, expectations for our operations and business, and our assumptions for those forecasts and expectations. Do not unduly rely on forward-looking statements. Actual results might differ materially from our forecasts and expectations due to several factors. Some of these factors are described in the Financial Review and in the Financial Statements and related Notes. For a discussion of other factors, refer to the Risk Factors section in this Report, our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 (First Quarter 2009 Form 10-Q), our Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 (Second Quarter 2009 Form 10-Q), and to the Risk Factors and Regulation and Supervision sections of our Annual Report on Form 10-K for the year ended December 31, 2008 (2008 Form 10-K), filed with the Securities and Exchange Commission (SEC) and available on the SEC s website at www.sec.gov. See page 145-146 for the Glossary of Acronyms for terms used throughout the Financial Review section of this Form 10-Q and page 147 for the Codification Cross Reference for cross references from accounting standards under the recently adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (Codification) to pre-Codification accounting standards.

OVERVIEW

Wells Fargo & Company is a $1.2 trillion diversified financial services company providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, brokerage and consumer finance through banking stores, the internet and other distribution channels to individuals, businesses and institutions in all 50 states, the District of Columbia (D.C.) and in other countries. We ranked fourth in assets and third in the market value of our common stock among our peers at September 30, 2009. When we refer to Wells Fargo, the Company, we, our or this Report, we mean Wells Fargo & Company and Subsidiaries (consolidated). When we refer to the Parent, we mean Wells Fargo & Company. When we refer to legacy Wells Fargo, we mean Wells Fargo excluding Wachovia Corporation (Wachovia).

Our vision is to satisfy all our customers financial needs, help them succeed financially, be recognized as the premier financial services company in our markets and be one of America s great companies. Our primary strategy to achieve this vision is to increase the number of products our customers buy from us and to give them all of the financial products that fulfill their needs. Our cross-sell strategy, diversified business model and the breadth of our geographic reach help facilitate growth in both strong and weak economic cycles, as we can grow by expanding the number of products our current customers have with us, gain new customers in our extended markets, and increase market share in many businesses. We continued to earn more of our customers business in 2009 in both our retail and commercial banking businesses and in our equally customer-centric securities brokerage and investment banking businesses.

On December 31, 2008, Wells Fargo acquired Wachovia. Because the acquisition was completed at the end of 2008, Wachovia s results are included in the income statement, average balances and related metrics beginning in 2009. Wachovia s assets and liabilities are included, at fair value, in the consolidated balance sheet beginning on December 31, 2008, but not in 2008 averages.

On January 1, 2009, we adopted new FASB guidance on noncontrolling interests on a retrospective basis for disclosure and, accordingly, prior period information reflects the adoption. The guidance requires that noncontrolling interests be reported as a component of total equity. In addition, our consolidated income statement must disclose amounts attributable to both Wells Fargo interests and the noncontrolling interests.

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Wells Fargo net income was a record $3.2 billion in third quarter 2009, with net income applicable to common stock of $2.6 billion. Diluted earnings per common share were $0.56, after a $1.0 billion build of the allowance for credit losses ($0.13 per common share) and merger-related and restructuring expenses of $249 million ($0.03 per common share).

We generated record earnings and built capital at a record rate in third quarter 2009 despite cyclically elevated credit costs. Our fundamental diversified business model continued to generate strong revenue in the current environment. Our cross-sell at legacy Wells Fargo set records for the 10th consecutive year an average of 5.90 products for retail banking households and an average of 6.4 products for wholesale and commercial customers. One of every four of our legacy Wells Fargo retail banking households has eight or more products and our average middle-market commercial banking customer has almost eight products. We believe there is potentially significant opportunity for growth as we increase the Wachovia retail bank household cross-sell. Business banking household cross-sell offers another potential opportunity for growth, with a cross-sell of 3.72 products at legacy Wells Fargo. Our goal is eight products per customer, which is approximately half of our estimate of potential demand.

Wells Fargo remains one of the largest providers of credit to the U.S. economy. We have extended more than $547 billion of new credit to creditworthy customers through third quarter 2009, including $169 billion in new loan commitments and originations this quarter. Average checking and savings deposits grew 11% (annualized) to $629.6 billion in third quarter 2009 from $613.3 billion in second quarter 2009 as we continued to gain new customers and deepen our relationships with existing customers.

We have stated in the past that to consistently grow over the long term, successful companies must invest in their core businesses and maintain strong balance sheets. In third quarter 2009, we opened 15 retail banking stores throughout the combined company for a retail network total of 6,653 stores. The first state community bank conversion (Colorado) of Wachovia stores to the Wells Fargo platform is scheduled for November, with the conversion of our remaining overlapping markets scheduled to occur in 2010.

The Wachovia integration remains on track and on schedule, with business and revenue synergies exceeding our expectations. Cross-sell revenues are already being realized. We are on track to realize annual run-rate savings of $5 billion upon completion of the Wachovia integration expected in 2011. We currently expect cumulative merger integration costs of approximately $5.5 billion, down from our previous $7.9 billion estimate. The revised estimate reflects lower owned real estate write-downs and lower employee-related expenses than anticipated at the time of the merger.

We continued taking actions during the quarter to further strengthen our balance sheet, including building the allowance for credit losses to $24.5 billion, reducing previously identified non-strategic and liquidating loan portfolios to $152.7 billion, and reducing the value of our debt and equity investment portfolios through $396 million of other-than-temporary impairment (OTTI) write-downs. Also, the value of our mortgage servicing rights (MSRs) as a percentage of loans serviced for others dropped to 83 basis points, in line with lower mortgage rates and the influence of new Federal mortgage modification programs on servicing costs and expected consumer refinancings. We significantly built capital in third quarter 2009, primarily driven by record retained earnings and other sources of internal capital generation. Tier 1 common equity increased to $53 billion, 5.18% of risk-weighted assets. Tier 1 leverage and Tier 1 capital ratios increased to 9.03% and 10.63%, respectively. While the Supervisory Capital Assessment Program (SCAP) will not be completed until after the end of the third quarter, we have already generated $20 billion from market and internal sources toward the $13.7 billion capital buffer required by the Federal Reserve, exceeding the requirement by $6 billion. See the Capital Management section in this Report for more information.

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We have seen signs of stability in our credit portfolio, as growth in credit losses slowed during third quarter 2009. We expect credit losses to remain elevated in the near term, but, assuming no further economic deterioration, current projections show credit losses peaking in the first half of 2010 in our consumer portfolios and later in 2010 in our commercial and commercial real estate portfolios. Our credit reserves as of September 30, 2009, reflected an improvement in consumer loss emergence, with all of the third quarter 2009 reserve build covering either higher commercial loss emergence or consumer troubled debt restructurings (TDRs).

We believe it is important to maintain a well controlled operating environment as we integrate the Wachovia businesses and grow the combined company. We manage our credit risk by setting what we believe are sound credit policies for underwriting new business, while monitoring and reviewing the performance of our loan portfolio. We manage the interest rate and market risks inherent in our asset and liability balances within prudent ranges, while ensuring adequate liquidity and funding. We maintain strong capital levels to facilitate future growth.

Wachovia Merger

On December 31, 2008, Wells Fargo acquired Wachovia, one of the nation s largest diversified financial services companies. Wachovia s assets and liabilities were included in the December 31, 2008, consolidated balance sheet at their respective fair values on the acquisition date. Because the acquisition was completed on December 31, 2008, Wachovia s results of operations were not included in our 2008 income statement. Beginning in 2009, our consolidated results and associated metrics, as well as our consolidated average balances, include Wachovia. The Wachovia acquisition was material to us, and the inclusion of results from Wachovia s businesses in our 2009 financial statements is a material factor in the changes in our results compared with prior year periods.

Because the transaction closed on the last day of the annual reporting period, certain fair value purchase accounting adjustments were based on preliminary data as of an interim period with estimates through year end. We have validated and, where necessary, refined our December 31, 2008, fair value estimates and other purchase accounting adjustments. The impact of these refinements was recorded as an adjustment to goodwill in the first nine months of 2009. Based on the purchase price of $23.1 billion and the $12.9 billion fair value of net assets acquired, inclusive of refinements identified during the first nine months of 2009, the transaction resulted in goodwill of $10.2 billion.

The more significant fair value adjustments in our purchase accounting for the Wachovia acquisition were to loans. As of December 31, 2008, certain of the loans acquired from Wachovia had evidence of credit deterioration since origination, and it was probable that we would not collect all contractually required principal and interest payments. Such loans identified at the time of the acquisition were accounted for using the measurement provisions for purchased credit-impaired (PCI) loans, which are contained in the Receivables topic (FASB ASC 310) of the Codification. PCI loans were recorded at fair value at the date of acquisition, and any related allowance for loan losses cannot be carried over.

PCI loans were written down to an amount estimated to be collectible. Accordingly, such loans are not classified as nonaccrual, even though they may be contractually past due, because we expect to fully collect the new carrying values of such loans (that is, the new cost basis arising out of our purchase accounting). PCI loans are also not included in the disclosure of loans 90 days or more past due and still accruing interest even though a portion of them are 90 days or more contractually past due.

Certain credit-related ratios of the Company, including the growth rate in nonperforming assets since December 31, 2008, may not be directly comparable with periods prior to the merger or with credit-related ratios of other financial institutions. As noted above, PCI loans were reclassified from nonaccrual

loans to accrual status. In addition, we believe our purchase accounting has resulted in some anomalies in our nonaccrual loan growth rate. For example, the percentage increase in nonaccrual loans may be higher than historical trends due in part to the minimal amount of nonaccrual loans from Wachovia at the beginning of 2009. For further detail on the merger see the Loan Portfolio section and Note 2 (Business Combinations) to Financial Statements in this Report.

Summary Results

Wells Fargo net income in third quarter 2009 was $3.2 billion ($0.56 per share), compared with $1.6 billion ($0.49 per share) in third quarter 2008. Net income for the first nine months of 2009 was $9.5 billion ($1.69 per share), compared with $5.4 billion ($1.62 per share) for the first nine months of 2008. Wells Fargo return on average total assets (ROA) was 1.03% and return on average common Wells Fargo stockholders equity (ROE) was 12.04% in third quarter 2009, compared with 1.06% and 13.63%, respectively, in third quarter 2008. ROA was 1.00% and ROE was 13.29% for the first nine months of 2009, and 1.21% and 15.02%, respectively, for the first nine months of 2008.

Revenue, the sum of net interest income and noninterest income, of $22.5 billion in third quarter 2009 was flat compared with second quarter 2009. Year-to-date revenue was $66.0 billion, more than double legacy Wells Fargo s revenue for the comparable period last year. The breadth and depth of our business model resulted in strong and balanced growth from a year ago in loans, deposits and fee-based products. While mortgage origination and hedging results contributed to our performance, collectively all of our other businesses have also grown pre-tax pre-provision profit (PTPP) each quarter this year reflecting the breadth of our diversified business model, record levels of sales and cross-sell, the realization of revenue synergies from the combination with Wachovia, and further improvements in our net interest margin to 4.36% and efficiency ratio to 52.0%.

We continued to maintain a strong balance sheet. Our allowance for credit losses was $24.5 billion at September 30, 2009, compared with $21.7 billion at December 31, 2008, and we believe was adequate for losses inherent in the loan portfolio at September 30, 2009, including both performing and nonperforming loans. We continued to reduce the higher risk assets on our balance sheet, with non-strategic and liquidating loan portfolios (home equity loans originated through third party channels and indirect auto at legacy Wells Fargo, Pick-a-Pay at Wachovia) down by $14.2 billion from December 31, 2008. We recorded $1.4 billion of OTTI write-downs on debt and equity securities available for sale in the first nine months of 2009.

Our financial results included the following:

Net interest income on a taxable-equivalent basis was $11.9 billion in third quarter 2009, up from $6.4 billion in third quarter 2008. While the net margin improved to 4.36%, average earning assets were down $23.7 billion from second quarter 2009, reflecting soft loan demand and reductions in non-strategic and liquidating assets. While average securities available for sale were up $7.3 billion, this largely reflected the averaging effect in the quarter of mortgage-backed securities (MBS) purchased late in the second quarter at yields more than 1% above the current market. During third quarter 2009, $23 billion of our lowest-yielding MBS were sold to reduce exposure to higher long-term interest rates. The net interest margin reflected the benefit of continued growth in checking and savings deposits, which represented about 83% of our core deposits in third quarter 2009.

Noninterest income reached $10.8 billion in third quarter 2009, up from $4.0 billion a year ago, largely driven by the Wachovia acquisition, as well as continued success in satisfying customers financial needs and the combined company s expanded breadth of products and services. Noninterest income included:

- Mortgage banking noninterest income of $3.1 billion in third quarter 2009;

$1.1 billion in revenue from mortgage loan originations/sales activities on $96 billion of new originations;

Mortgage applications of $123 billion, with an unclosed application pipeline of $62 billion at quarter end; and

$1.5 billion combined market-related valuation changes to MSRs and economic hedges (consisting of a $2.1 billion decrease in the fair value of the MSRs more than offset by a $3.6 billion economic hedge gain in the quarter), largely due to hedge-carry income reflecting the current low short-term interest rate environment (the low short-term interest rate environment is expected to continue into fourth quarter 2009); MSRs as a percentage of loans serviced for others reduced to 0.83%; average servicing portfolio note rate was only 5.72%.

Trust and investment fees of $2.5 billion primarily reflecting an increase in client assets, bond origination fees, and higher brokerage revenue as we continued to build our retail securities brokerage business; client assets in Wealth, Brokerage and Retirement were up 8% from second quarter 2009 driven largely by the strong equity market recovery;

Card fees of $946 million reflecting seasonally higher purchase volumes and higher customer penetration rates;

Service charges on deposit accounts of $1.5 billion driven by continued strong checking account growth; and

Net losses on debt and equity securities totaling $11 million, including $396 million of OTTI write-downs and $120 million of realized gains on the sale of MBS in the third quarter. After having purchased over $34 billion of agency MBS in the second quarter of 2009 at yields more than 1% above the current market, we sold $23 billion of our lowest-yielding MBS after long-term interest rates declined in the third quarter.

Due to the general decline in long-term yields and narrowing of credit spreads in third quarter 2009, net unrealized gains on securities available for sale increased to $6.6 billion at September 30, 2009, from net unrealized losses of $400 million at June 30, 2009.

Noninterest expense was $11.7 billion in third quarter 2009, up from $5.5 billion in third quarter 2008, predominantly attributable to the Wachovia acquisition. Noninterest expense in third quarter 2009 reflected $200 million of Wachovia merger-related costs and $49 million of non-Wachovia-related integration costs. Noninterest expense also included $100 million of additional insurance reserve at our captive mortgage reinsurance operation. Noninterest expense in third quarter 2009 declined from $12.7 billion in second quarter 2009, which included $565 million of Federal Deposit Insurance Corporation (FDIC) deposit insurance assessments. The balance of the decline from second quarter 2009 was due to merger consolidation savings and ongoing expense management initiatives. As we reduce expenses through consolidation and other expense initiatives, we continue to reinvest in our businesses for long-term revenue growth. During 2009, we opened 41 retail banking stores, including 15 in the third quarter, and converted 1,274 ATMs to *Envelope-Free*[SM] *webATM* machines. We have also continued to increase the level and productivity of our sales force in community banking, commercial banking and wealth management. We continued to manage to a variable expense base in the mortgage company. Part-time staff was reduced in third quarter as application volume declined, and increased again in September and early in the fourth quarter as the volume of applications increased. Our efficiency ratio improved to 52.0% in third quarter 2009 from 56.4% in second quarter 2009.

Net charge-offs in third quarter 2009 were $5.1 billion (2.50% of average total loans outstanding, annualized), compared with $4.4 billion (2.11%) in second quarter 2009 and $2.0 billion (1.96%) in third quarter 2008. While losses were up in the quarter, the increase in terms of both dollars and percentages moderated from prior quarter growth. Net charge-offs of $5.1 billion in third quarter 2009 included $1.5 billion of commercial and commercial real estate loans (1.78%) and $3.6 billion in consumer loans (3.13%). Legacy Wells Fargo net charge-offs were $3.4 billion in third quarter 2009, flat compared with

second quarter 2009, and Wachovia net charge-offs totaled $1.7 billion (including $225 million related to PCI loans), compared with $984 million in second quarter 2009. Wachovia s PCI loans were written down to fair value at December 31, 2008, and, accordingly, charge-offs on that portfolio only occur if the portfolio deteriorates more than was expected at the date of acquisition.

Commercial and commercial real estate charge-offs were up 28% in third quarter 2009 from second quarter 2009. The increase in commercial and commercial real estate losses in third quarter 2009 was entirely in the Wachovia portfolio, in part reflecting the fact that charge-offs are just now coming through Wachovia s portfolio after having eliminated nonaccruals through purchase accounting at the end of 2008. The overall loss rate in third quarter 2009 for Wachovia s commercial and commercial real estate portfolio was roughly comparable to Wells Fargo s commercial portfolio, which we believe was underwritten to conservative credit standards. In fact, legacy Wells Fargo s commercial and commercial real estate losses declined $35 million, or 4%, from second quarter 2009.

Consumer losses were up 12% in third quarter 2009, with virtually all of the increase in Wachovia s consumer portfolios. Over 40% of the increase in Wachovia consumer loan losses came from the non-impaired Pick-a-Pay portfolio, in large part reflecting the lagging effect of purchase accounting.

The provision for credit losses was $6.1 billion and $15.8 billion in the third quarter and first nine months of 2009, respectively, compared with $2.5 billion and $7.5 billion, respectively, in the same periods a year ago. The provision in the third quarter and first nine months of 2009 included $1.0 billion and $3.0 billion, respectively, of net build to the allowance for credit losses due to higher credit losses inherent in the loan portfolio. The allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, was $24.5 billion (3.07% of total loans) at September 30, 2009, compared with $21.7 billion (2.51%) at December 31, 2008.

Total nonaccrual loans were $20.9 billion (2.61% of total loans) at September 30, 2009, compared with $15.8 billion (1.92%) at June 30, 2009. Nonaccrual loans exclude PCI loans acquired from Wachovia since these loans were written down in purchase accounting as of December 31, 2008, to an amount expected to be collectible. The increase in nonaccrual loans represented increases in both the commercial and consumer portfolios, with $3.7 billion related to Wachovia in third quarter 2009. The increase in nonaccrual loans was concentrated in portfolios secured by real estate or with borrowers dependent on the housing industry. Total nonperforming assets (NPAs) were $23.5 billion (2.93% of total loans) at September 30, 2009, compared with $18.3 billion (2.23%) at June 30, 2009.

While commercial and commercial real estate nonaccrual loans were up in third quarter 2009, the dollar amount of the increase declined in third quarter 2009 and the rate of growth slowed considerably. Legacy Wells Fargo s commercial and commercial real estate nonaccrual loans increased $777 million. Wachovia s commercial and commercial real estate nonaccrual loans increased $1.9 billion. The growth rate in consumer nonaccrual loans slowed in third quarter 2009. Legacy Wells Fargo s consumer nonaccrual loans increased $606 million, reflecting the more moderate deterioration we have experienced in consumer loans. Wachovia s Pick-a-Pay portfolio represented the largest portion of consumer nonaccrual loans. While up $1.2 billion in third quarter 2009 from second quarter 2009, the increase in nonaccrual loans in the non-impaired Pick-a-Pay portfolio reflected the inflows to nonaccruals expected in the first few quarters after purchase accounting write-downs. Due to our active loss mitigation efforts on Pick-a-Pay loans, some of our modifications on the non-PCI portfolio are classified as TDRs causing our NPA levels to remain elevated until the loans can demonstrate performance. To the extent these nonperforming loans return to accrual status, NPA growth may moderate.

We continued to build capital in third quarter 2009 and the Company and each of its subsidiary banks continued to remain well-capitalized. Our total risk-based capital (RBC) ratio at September 30, 2009, was 14.66% and our Tier 1 RBC ratio was 10.63%, exceeding the minimum regulatory guidelines of 8% and 4%, respectively, for bank holding companies. Our total RBC ratio was 11.83% and our Tier 1 RBC ratio was 7.84% at December 31, 2008. Tier 1 RBC and Tier 1 common equity ratios increased to 10.63% and 5.18%, respectively, at September 30, 2009, up from 9.80% and 4.49%, respectively, at June 30, 2009. Our Tier 1 leverage ratio was 9.03% at September 30, 2009, and 14.52% at December 31, 2008, exceeding the minimum regulatory guideline of 3% for bank holding companies.
As previously disclosed, the Federal Reserve asked us to generate a $13.7 billion regulatory capital buffer by November 9, 2009, based on their revenue assumptions in the adverse case economic scenario. Through September 30, 2009, we generated $20 billion toward the $13.7 billion regulatory capital buffer under SCAP, exceeding the requirement by $6 billion. We accomplished this through an $8.6 billion equity raise in second quarter 2009 and by internally generated capital, which has been tracking above the Company s internal SCAP estimates and 35% above the supervisory adverse economic scenario estimate. See the Capital Management section in this Report for more information.

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Current Accounting Developments

Effective July 1, 2009, the FASB established the Codification as the source of authoritative generally accepted accounting principles (GAAP) for companies to use in the preparation of financial statements. SEC rules and interpretive releases are also authoritative GAAP for SEC registrants. The guidance contained in the Codification supersedes all existing non-SEC accounting and reporting standards. We adopted the Codification, as required, in third quarter 2009. As a result, references to accounting literature contained in our financial statement disclosures have been updated to reflect the new Accounting Standards Codification (ASC) structure. References to superseded authoritative literature are shown parenthetically below, and cross-references to pre-Codification accounting standards are included on page 147.

In first quarter 2009, we adopted new guidance related to the following Codification topics:

FASB ASC 815-10, *Derivatives and Hedging* (FAS 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*);

FASB ASC 810-10, *Consolidation* (FAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*);

FASB ASC 805-10, *Business Combinations* (FAS 141R (revised 2007), *Business Combinations*);

FASB ASC 820-10, *Fair Value Measurements and Disclosures* (FASB Staff Position (FSP) FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*);

FASB ASC 320-10, *Investments Debt and Equity Securities* (FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*); and

FASB ASC 260-10, *Earnings Per Share* (FSP Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*).

In second quarter 2009, we adopted new guidance related to the following Codification topics:

FASB ASC 825-10, *Financial Instruments* (FSP FAS 107-1 and APB Opinion 28-1, *Interim Disclosures about Fair Value of Financial Instruments)*; and

FASB ASC 855-10, *Subsequent Events* (FAS 165, *Subsequent Events)*.

In third quarter 2009, we adopted new guidance related to the following Codification topic:

FASB ASC 105-10, *Generally Accepted Accounting Principles* (FAS 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162*).

In addition, the following accounting pronouncements were issued by the FASB, but are not yet effective:

FAS 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140*;

FAS 167, *Amendments to FASB Interpretation No. 46(R)*;

FASB ASC 715-20, *Compensation Retirement Benefits* (FSP FAS 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets*);

Accounting Standards Update (ASU or Update) 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*; and

ASU 2009-5, *Measuring Liabilities at Fair Value.*

Information about these pronouncements is described in more detail below.

FASB ASC 815-10 (FAS 161) changes the disclosure requirements for derivative instruments and hedging activities. It requires enhanced disclosures about how and why an entity uses derivatives, how derivatives and related hedged items are accounted for, and how derivatives and hedged items affect an entity s financial position, performance and cash flows. We adopted this pronouncement for first quarter 2009 reporting. See Note 11 (Derivatives) to Financial Statements in this Report for complete disclosures on derivatives and hedging activities. This standard does not affect our consolidated financial results since it amends only the disclosure requirements for derivative instruments and hedged items.

FASB ASC 810-10 (FAS 160) requires that noncontrolling interests (previously referred to as minority interests) be reported as a component of equity in the balance sheet. Prior to our adoption of this standard, noncontrolling interests were classified outside of equity. This new guidance also changes the way a noncontrolling interest is presented in the income statement such that a parent s consolidated income statement includes amounts attributable to both the parent s interest and the noncontrolling interest. When a subsidiary is deconsolidated, a parent is required to recognize a gain or loss with any remaining interest initially recorded at fair value. Other changes in ownership interest where the parent continues to have a majority ownership interest in the subsidiary are accounted for as capital transactions. This new guidance was effective on January 1, 2009, with prospective application to all noncontrolling interests including those that arose prior to adoption. Retrospective adoption was required for disclosure of noncontrolling interests held as of the adoption date.

We hold a controlling interest in a joint venture with Prudential Financial, Inc. (Prudential). For more information on the Prudential joint venture, see the Capital Management section in this Report. On January 1, 2009, we reclassified Prudential s noncontrolling interest to equity. Under the terms of the original agreement under which the joint venture was established between Wachovia and Prudential, each party has certain rights such that changes in our ownership interest can occur. On December 4, 2008, Prudential publicly announced its intention to exercise its option to put its noncontrolling interest to us at the end of the lookback period, as defined (January 1, 2010). As a result of issuance of new accounting requirements for noncontrolling interests, related interpretive guidance, and Prudential s stated intention, on January 1, 2009, we increased the carrying value of Prudential s noncontrolling interest in the joint venture to the estimated maximum redemption amount, with the offset recorded to additional paid-in capital.

FASB ASC 805-10 (FAS 141R) requires an acquirer in a business combination to recognize the assets acquired (including loan receivables), the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date at their fair values as of that date, with limited exceptions. The acquirer is not permitted to recognize a separate valuation allowance as of the acquisition date for loans and other assets acquired in a business combination. The revised statement requires acquisition-related costs to be expensed separately from the acquisition. It also requires restructuring costs that the acquirer expected but was not obligated to incur to be expensed separately from the business combination. This standard was applicable prospectively to business combinations completed on or after January 1, 2009.

FASB ASC 820-10 (FSP FAS 157-4) addresses measuring fair value in situations where markets are inactive and transactions are not orderly. The guidance acknowledges that in these circumstances quoted prices may not be determinative of fair value; however, even if there has been a significant decrease in the volume and level of activity for an asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement has not changed. Prior to issuance of this pronouncement, many companies, including Wells Fargo, interpreted accounting guidance on fair value measurements to emphasize that fair value must be measured based on the most recently available quoted market prices, even for markets that have experienced a significant decline in the volume and level of activity relative to

normal conditions and therefore could have increased frequency of transactions that are not orderly. Under the provisions of this standard, price quotes for assets or liabilities in inactive markets may require adjustment due to uncertainty as to whether the underlying transactions are orderly.

For inactive markets, there is little information, if any, to evaluate if individual transactions are orderly. Accordingly, we are required to estimate, based upon all available facts and circumstances, the degree to which orderly transactions are occurring. The Fair Value Measurements and Disclosures topic in the Codification does not prescribe a specific method for adjusting transaction or quoted prices; however, it does provide guidance for determining how much weight to give transaction or quoted prices. Price quotes based upon transactions that are not orderly are not considered to be determinative of fair value and should be given little, if any, weight in measuring fair value. Price quotes based upon transactions that are orderly shall be considered in determining fair value, with the weight given based upon the facts and circumstances. If sufficient information is not available to determine if price quotes are based upon orderly transactions, less weight should be given to the price quote relative to other transactions that are known to be orderly.

The new measurement provisions of FASB ASC 820-10 were effective for second quarter 2009; however, as permitted under the pronouncement, we early adopted in first quarter 2009. Adoption of this pronouncement resulted in an increase in the valuation of securities available for sale in first quarter 2009 of $4.5 billion ($2.8 billion after tax), which was included in other comprehensive income (OCI), and trading assets of $18 million, which was reflected in earnings. See the Critical Accounting Policies section in this Report for more information.

FASB ASC 320-10 (FSP FAS 115-2 and FAS 124-2) states that an OTTI write-down of debt securities, where fair value is below amortized cost, is triggered in circumstances where (1) an entity has the intent to sell a security, (2) it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, or (3) the entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security s amortized cost basis and its fair value. If an entity does not intend to sell the security or it is more likely than not that it will not be required to sell the security before recovery, the OTTI write-down is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in OCI. The new accounting requirements for recording OTTI on debt securities were effective for second quarter 2009; however, as permitted under the pronouncement, we early adopted on January 1, 2009, and increased the beginning balance of retained earnings by $85 million ($53 million after tax) with a corresponding adjustment to cumulative OCI for OTTI recorded in previous periods on securities in our portfolio at January 1, 2009, that would not have been required had this accounting guidance been effective for those periods.

FASB ASC 260-10 (FSP EITF 03-6-1) requires that unvested share-based payment awards that have nonforfeitable rights to dividends or dividend equivalents be treated as participating securities and, therefore, included in the computation of earnings per share under the two-class method described in the Earnings per Share topic in the Codification. This pronouncement was effective on January 1, 2009, with retrospective adoption required. The adoption of this standard did not have a material effect on our consolidated financial statements.

FASB ASC 825-10 (FSP FAS 107-1 and APB 28-1) states that entities must disclose the fair value of financial instruments in interim reporting periods as well as in annual financial statements. Entities must also disclose the methods and assumptions used to estimate fair value as well as any changes in methods and assumptions that occurred during the reporting period. We adopted this pronouncement in second

quarter 2009. See Note 12 (Fair Values of Assets and Liabilities) to Financial Statements in this Report for additional information. Because the new provisions in FASB ASC 825-10 amend only the disclosure requirements related to the fair value of financial instruments, the adoption of this pronouncement does not affect our consolidated financial statements.

FASB ASC 855-10 (FAS 165) describes two types of subsequent events that previously were addressed in the auditing literature, one that requires post-period end adjustment to the financial statements being issued, and one that requires footnote disclosure only. Companies are also required to disclose the date through which management has evaluated subsequent events, which for public entities is the date that financial statements are issued. The requirements for disclosing subsequent events were effective in second quarter 2009 with prospective application. See Note 1 (Summary of Significant Accounting Policies) to Financial Statements in this Report for our discussion of subsequent events. Our adoption of this standard did not have a material impact on our consolidated financial statements.

FAS 166 modifies certain guidance contained in FASB ASC 860, *Transfers and Servicing*. This standard eliminates the concept of qualifying special purpose entities (QSPEs) and provides additional criteria transferors must use to evaluate transfers of financial assets. To determine if a transfer is to be accounted for as a sale, the transferor must assess whether it and all of the entities included in its consolidated financial statements have surrendered control of the assets. A transferor must consider all arrangements or agreements made or contemplated at the time of transfer before reaching a conclusion on whether control has been relinquished. FAS 166 addresses situations in which a portion of a financial asset is transferred. In such instances the transfer can only be accounted for as a sale when the transferred portion is considered to be a participating interest. FAS 166 also requires that any assets or liabilities retained from a transfer accounted for as a sale be initially recognized at fair value. This standard is effective for us as of January 1, 2010, with adoption applied prospectively for transfers that occur on and after the effective date.

FAS 167 amends several key consolidation provisions related to variable interest entities (VIEs), which are included in FASB ASC 810, *Consolidation*. First, the scope of FAS 167 includes entities that are currently designated as QSPEs. Second, FAS 167 changes the approach companies use to identify the VIEs for which they are deemed to be the primary beneficiary and are required to consolidate. Under existing rules, the primary beneficiary is the entity that absorbs the majority of a VIE s losses and receives the majority of the VIE s returns. The guidance in FAS 167 identifies a VIE s primary beneficiary as the entity that has the power to direct the VIE s significant activities, and has an obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. Third, FAS 167 requires companies to continually reassess whether they are the primary beneficiary of a VIE. Existing rules only require companies to reconsider primary beneficiary conclusions when certain triggering events have occurred. FAS 167 is effective for us as of January 1, 2010, and applies to all current QSPEs and VIEs, and VIEs created after the effective date.

Application of FAS 166 and FAS 167 will result in the January 1, 2010, consolidation of certain QSPEs and VIEs that are not currently included in our consolidated financial statements. We have performed a preliminary analysis of these accounting standards with respect to QSPE and VIE structures currently applicable to us. Our preliminary estimate includes entities in which we have the power to direct significant activities through our servicing and advisory activities as well as variable interests that expose us to benefits or risks that could potentially be significant.

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ESTIMATED IMPACT OF APPLICATION OF FAS 166 AND FAS 167

(in billions)		Incremental GAAP assets	Incremental risk-weighted assets
Residential mortgage loans nonconforming (1) (2)	$	28	18
Other consumer loans		6	3
Commercial paper conduit		6	
Investment funds		8	4
Total	$	48	25

(1) Represents certain of our residential mortgage loans that are not guaranteed by government-sponsored entities (nonconforming). With the concurrence of our independent auditors, we have concluded that conforming residential mortgage loans involved in securitizations are not subject to consolidation under FAS 166 and FAS 167.

(2) We are actively exploring the sale of certain interests we hold in securitized residential mortgage loans, which would reduce the amount of residential mortgage loans subject to consolidation under FAS 167. There is no assurance that we will be able to execute such sales prior to adoption of these accounting

standards, although it is
our intent to do so.

FAS 166 and FAS 167 are principles based and limited interpretive guidance is currently available. We will continue to evaluate QSPE and VIE structures applicable to us, monitor interpretive guidance, and work with our external auditors and other appropriate interested parties to properly implement these standards. In addition, we are evaluating the impact of potential fair value option elections. Accordingly, the amount of assets that actually become consolidated on our financial statements upon implementation of these standards on January 1, 2010, may differ from our preliminary analysis presented in the previous table. The cumulative effect of adopting these statements will be recorded as an adjustment to retained earnings at January 1, 2010.

FASB ASC 715-20 (FSP FAS 132 (R)-1) requires new disclosures that are applicable to the plan assets of our Cash Balance Plan and other postretirement benefit plans. The objectives of the new disclosures are to provide an understanding of how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure fair value, the effect of fair value measurements using significant unobservable inputs on the changes in plan assets and significant concentrations of risk within plan assets. The new disclosures on postretirement benefits will be required prospectively for fiscal years ending after December 15, 2009.

ASU 2009-12 provides guidance for determining the fair value of certain alternative investments, which include hedge funds, private equity funds, and real estate funds. When alternative investments do not have readily determinable fair values, companies are permitted to use unadjusted net asset values or an equivalent measure to estimate fair value. This provision is only allowable for investments in entities that calculate net asset value (NAV) per share or its equivalent in accordance with Codification Topic 946, *Financial Services Investment Companies.* The guidance also requires a company to consider its ability to redeem an investment at NAV when determining the appropriate classification of the related fair value measurement within the fair value hierarchy. ASU 2009-12 is effective for us in fourth quarter 2009 with prospective application. We are currently evaluating the impact ASU 2009-12 may have on our financial statements.

ASU 2009-5 describes the valuation techniques companies should use to measure the fair value of liabilities for which there is limited observable market data. If a quoted price in an active market is not available for an identical liability, an entity should use one of the following approaches: (1) the quoted price of the identical liability when traded as an asset, (2) quoted prices for similar liabilities or similar liabilities when traded as an asset, or (3) another valuation technique that is consistent with the principles of FASB ASC 820, *Fair Value Measurements and Disclosures*. When measuring the fair value of liabilities, this Update reiterates that companies should apply valuation techniques that maximize the use of relevant observable inputs, which is consistent with existing accounting provisions for fair value measurement. In addition, this Update clarifies when an entity should adjust quoted prices of identical or similar assets that are used to estimate the fair value of liabilities. For example, an entity should not include separate adjustments for contractual restrictions that prevent the transfer of the liability because the restriction would be factored into other inputs used in the fair value measurement of the liability. However, separate adjustments are needed in situations where the unit of account for the asset is not the same as for the liability. This guidance is effective for us in fourth quarter 2009 with adoption applied prospectively. We are currently evaluating the impact ASU 2009-5 may have on our financial statements.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are fundamental to understanding our results of operations and financial condition because they require that we use estimates and assumptions that may affect the value of our assets or liabilities, and our financial results. Six of these policies are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. These policies govern:

- the allowance for credit losses;
- PCI loans;
- the valuation of residential mortgage servicing rights (MSRs);
- the fair valuation of financial instruments;
- pension accounting; and
- income taxes.

With respect to pension accounting, on April 28, 2009, the Board of Directors (the Board) approved amendments to freeze the benefits earned under the Wells Fargo qualified and supplemental cash balance plans and Wachovia s cash balance pension plan, and to merge Wachovia s plan into the Wells Fargo Cash Balance Plan. These actions became effective on July 1, 2009. This is expected to reduce pension cost in future periods. See Note 14 (Employee Benefits) to Financial Statements in this Report for additional information.

Management has reviewed and approved these critical accounting policies and has discussed these policies with the Audit and Examination Committee of the Board. These policies are described in the Financial Review Critical Accounting Policies section and Note 1 (Summary of Significant Accounting Policies) to Financial Statements in our 2008 Form 10-K. Due to the adoption of new accounting provisions contained in FASB ASC 820-10, which affects the measurement of fair value of certain assets, principally securities and trading assets, we have updated the policy on the fair value of financial instruments, as described below.

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FAIR VALUE OF FINANCIAL INSTRUMENTS

We use fair value measurements to record fair value adjustments to certain financial instruments and to develop fair value disclosures. See our 2008 Form 10-K for the complete critical accounting policy related to fair value of financial instruments.

In connection with the adoption of new fair value measurement guidance included in FASB ASC 820, *Fair Value Measurements and Disclosures,* we developed policies and procedures to determine when the level and volume of activity for our assets and liabilities requiring fair value measurements have declined significantly relative to normal conditions. For items that use price quotes, such as certain security classes within securities available for sale, the degree of market inactivity and distressed transactions is estimated to determine the appropriate adjustment to the price quotes from an external broker or pricing service. The methodology we use to adjust the quotes generally involves weighting the price quotes and results of internal pricing techniques, such as the net present value of future expected cash flows (with observable inputs, where available) discounted at a rate of return market participants require to arrive at the fair value. The more active and orderly markets for particular security classes are determined to be, the more weighting we assign to price quotes. The less active and orderly markets are determined to be, the less weighting we assign to price quotes.

In the determination of the classification of financial instruments in Level 2 or Level 3 of the fair value hierarchy, we consider all available information, including observable market data, indications of market liquidity and orderliness, and our understanding of the valuation techniques and significant inputs used. For securities in inactive markets, we use a predetermined percentage to evaluate the impact of fair value adjustments derived from weighting both external and internal indications of value to determine if the instrument is classified as Level 2 or Level 3. Based upon the specific facts and circumstances of each instrument or instrument category, judgments are made regarding the significance of the Level 3 inputs to the instruments fair value measurement in its entirety. If Level 3 inputs are considered significant, the instrument is classified as Level 3.

Approximately 23% of total assets ($285.6 billion) at September 30, 2009, and 19% of total assets ($247.5 billion) at December 31, 2008, consisted of financial instruments recorded at fair value on a recurring basis. Assets for which fair values were measured using significant Level 3 inputs (before derivative netting adjustments) represented approximately 19% of these financial instruments (4% of total assets) at September 30, 2009, and approximately 22% (4% of total assets) at December 31, 2008. The fair value of the remaining assets was measured using valuation methodologies involving market-based or market-derived information, collectively Level 1 and 2 measurements.

Approximately 2% of total liabilities ($23.5 billion) at September 30, 2009, and 2% ($18.8 billion) at December 31, 2008, consisted of financial instruments recorded at fair value on a recurring basis. Liabilities valued using Level 3 measurements (before derivative netting adjustments) were $7.9 billion at September 30, 2009, and $9.3 billion at December 31, 2008.

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EARNINGS PERFORMANCE

NET INTEREST INCOME

Net interest income is the interest earned on debt securities, loans (including yield-related loan fees) and other interest-earning assets minus the interest paid for deposits, short-term borrowings and long-term debt. The net interest margin is the average yield on earning assets minus the average interest rate paid for deposits and our other sources of funding. Net interest income and the net interest margin are presented on a taxable-equivalent basis to consistently reflect income from taxable and tax-exempt loans and securities based on a 35% federal statutory tax rate.

Net interest income on a taxable-equivalent basis was $11.9 billion in third quarter 2009 and $6.4 billion in third quarter 2008. While the net margin improved to 4.36%, average earning assets were down $23.7 billion from second quarter 2009, reflecting soft loan demand and reductions in non-strategic and liquidating assets. While average securities available for sale were up $7.3 billion, this largely reflected the averaging effect in the quarter of MBS purchased late in the second quarter at yields more than 1% above the current market. During third quarter 2009, $23 billion of our lowest-yielding MBS were sold to reduce exposure to higher long-term interest rates. Net interest income also reflected the benefit of growth in checking and savings deposits.

Average earning assets increased to $1.1 trillion in third quarter 2009 from $533.2 billion in third quarter 2008. Average loans increased to $810.2 billion in third quarter 2009 from $404.2 billion a year ago. Average mortgages held for sale (MHFS) increased to $40.6 billion in third quarter 2009 from $25.0 billion a year ago. Average debt securities available for sale increased to $186.3 billion in third quarter 2009 from $92.9 billion a year ago.

Core deposits are a low-cost source of funding and thus an important contributor to net interest income and the net interest margin. Core deposits include noninterest-bearing deposits, interest-bearing checking, savings certificates, market rate and other savings, and certain foreign deposits (Eurodollar sweep balances). Average core deposits rose to $759.3 billion in third quarter 2009 from $320.1 billion in third quarter 2008, with over half of the increase from Wachovia, and funded 94% and 79% of average loans in third quarter 2009 and 2008, respectively. Checking and savings deposits, typically the lowest cost deposits, now represent about 83% of our core deposits, one of the highest percentages in the industry. Total average retail core deposits, which exclude Wholesale Banking core deposits and retail mortgage escrow deposits, grew to $584.4 billion for third quarter 2009 from $234.1 billion a year ago. Average mortgage escrow deposits were $28.7 billion in third quarter 2009, compared with $21.2 billion a year ago. Average certificates of deposits increased to $129.7 billion in third quarter 2009 from $37.2 billion a year ago and average checking and savings deposits increased to $629.6 billion from $282.9 billion a year ago. Total average interest-bearing deposits increased to $633.4 billion in third quarter 2009 from $266.4 billion a year ago.

The following table presents the individual components of net interest income and the net interest margin.

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AVERAGE BALANCES, YIELDS AND RATES PAID (TAXABLE-EQUIVALENT BASIS) (1)(2)

				Quarter ended September 30,		
			2009			2008
(in millions)	**Average balance**	**Yields/ rates**	**Interest income/ expense**	Average balance	Yields/ rates	Interest income/ expense
Earning assets						
Federal funds sold, securities purchased under resale agreements and other short-term investments	**$ 16,356**	**0.66%**	**$ 27**	3,463	2.09%	$ 18
Trading assets	**20,518**	**4.29**	**221**	4,838	3.72	46
Debt securities available for sale (3):						
Securities of U.S. Treasury and federal agencies	**2,545**	**3.79**	**24**	1,141	3.99	11
Securities of U.S. states and political subdivisions	**12,818**	**6.28**	**204**	7,211	6.65	124
Mortgage-backed securities:						
Federal agencies	**94,457**	**5.34**	**1,221**	50,528	5.83	731
Residential and commercial	**43,214**	**9.56**	**1,089**	21,358	5.82	346
Total mortgage-backed securities	**137,671**	**6.75**	**2,310**	71,886	5.83	1,077
Other debt securities (4)	**33,294**	**7.00**	**568**	12,622	7.17	248
Total debt securities available for sale (4)	**186,328**	**6.72**	**3,106**	92,860	6.06	1,460
Mortgages held for sale (5)	**40,604**	**5.16**	**524**	24,990	6.31	394
Loans held for sale (5)	**4,975**	**2.67**	**34**	677	6.95	12
Loans:						
Commercial and commercial real estate:						
Commercial	**175,642**	**4.34**	**1,919**	100,688	5.92	1,496
Real estate mortgage	**103,450**	**3.39**	**883**	43,616	5.60	615
Real estate construction	**32,649**	**3.02**	**249**	19,715	4.82	238
Lease financing	**14,360**	**9.14**	**328**	7,250	5.48	100
Total commercial and commercial real estate	**326,101**	**4.12**	**3,379**	171,269	5.69	2,449
Consumer:						
Real estate 1-4 family first mortgage	**235,051**	**5.35**	**3,154**	76,197	6.64	1,265
Real estate 1-4 family junior lien mortgage	**105,779**	**4.62**	**1,229**	75,379	6.36	1,206
Credit card	**23,448**	**11.65**	**683**	19,948	12.19	609
Other revolving credit and installment	**90,199**	**6.48**	**1,473**	54,104	8.64	1,175
Total consumer	**454,477**	**5.73**	**6,539**	225,628	7.52	4,255

Foreign	**29,613**	**3.61**	**270**	7,306	10.28	188
Total loans (5)	**810,191**	**5.00**	**10,188**	404,203	6.79	6,892
Other	**6,088**	**3.29**	**49**	2,126	4.64	24
Total earning assets	**$ 1,085,060**	**5.20%**	**$ 14,149**	533,157	6.57%	$ 8,846
Funding sources						
Deposits:						
Interest-bearing checking	**$ 59,467**	**0.15%**	**$ 21**	5,483	0.87%	$ 12
Market rate and other savings	**369,120**	**0.34**	**317**	166,710	1.18	495
Savings certificates	**129,698**	**1.35**	**442**	37,192	2.57	240
Other time deposits	**18,248**	**1.93**	**89**	7,930	2.59	53
Deposits in foreign offices	**56,820**	**0.25**	**36**	49,054	1.78	219
Total interest-bearing deposits	**633,353**	**0.57**	**905**	266,369	1.52	1,019
Short-term borrowings	**39,828**	**0.35**	**36**	83,458	2.35	492
Long-term debt	**222,580**	**2.33**	**1,301**	103,745	3.43	892
Other liabilities	**5,620**	**3.30**	**46**			
Total interest-bearing liabilities	**901,381**	**1.01**	**2,288**	453,572	2.11	2,403
Portion of noninterest-bearing funding sources	**183,679**			79,585		
Total funding sources	**$ 1,085,060**	**0.84**	**2,288**	533,157	1.78	2,403
Net interest margin and net interest income on a taxable-equivalent basis (6)		**4.36%**	**$ 11,861**		4.79%	$ 6,443
Noninterest-earning assets						
Cash and due from banks	**$ 18,084**			11,024		
Goodwill	**24,435**			13,531		
Other	**118,472**			56,482		
Total noninterest-earning assets	**$ 160,991**			81,037		
Noninterest-bearing funding sources						
Deposits	**$ 172,588**			87,095		
Other liabilities	**47,646**			25,452		
Total equity	**124,436**			48,075		
Noninterest-bearing funding sources used to fund earning assets	**(183,679)**			(79,585)		
Net noninterest-bearing funding sources	**$ 160,991**			81,037		
Total assets	**$ 1,246,051**			614,194		

(1) Our average prime rate was 3.25% and 5.00% for the quarters ended September 30, 2009 and 2008, respectively, and 3.25% and 5.43% for the first nine months of 2009 and 2008, respectively. The average three-month London Interbank Offered Rate (LIBOR) was 0.41% and 2.91% for the quarters ended September 30, 2009 and 2008, respectively, and 0.83% and 2.98% for the first nine months of 2009 and 2008, respectively.

(2) Interest rates and amounts include the effects of hedge and risk management activities associated with the respective asset and liability categories.

(3) Yields are based on amortized cost balances computed on a settlement date basis.

(4) Includes certain preferred securities.

(5) Nonaccrual loans and related income are included in their respective loan categories.

(6) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities. The federal statutory tax rate was 35% for the periods presented.

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	Nine months ended September 30,					
			2009			2008
(in millions)	**Average balance**	**Yields/ rates**	**Interest income/ expense**	Average balance	Yields/ rates	Interest income/ expense
Earning assets						
Federal funds sold, securities purchased under resale agreements and other short-term investments	**$ 20,411**	**0.73%**	**$ 111**	3,734	2.59%	$ 72
Trading assets	**20,389**	**4.64**	**709**	4,960	3.57	133
Debt securities available for sale (3):						
Securities of U.S. Treasury and federal agencies	**2,514**	**2.61**	**48**	1,055	3.88	30
Securities of U.S. states and political subdivisions	**12,409**	**6.39**	**623**	6,848	6.88	362
Mortgage-backed securities:						
Federal agencies	**87,916**	**5.45**	**3,492**	42,448	5.93	1,854
Residential and commercial	**41,070**	**9.05**	**3,150**	21,589	5.92	1,010
Total mortgage-backed securities	**128,986**	**6.72**	**6,642**	64,037	5.92	2,864
Other debt securities (4)	**31,437**	**7.01**	**1,691**	12,351	6.78	670
Total debt securities available for sale (4)	**175,346**	**6.69**	**9,004**	84,291	6.11	3,926
Mortgages held for sale (5)	**38,315**	**5.16**	**1,484**	26,417	6.11	1,211
Loans held for sale (5)	**6,693**	**3.01**	**151**	686	6.66	34
Loans:						
Commercial and commercial real estate:						
Commercial	**186,610**	**4.10**	**5,725**	95,697	6.29	4,509
Real estate mortgage	**104,003**	**3.44**	**2,677**	40,351	5.91	1,788
Real estate construction	**33,660**	**2.92**	**734**	19,288	5.29	763
Lease financing	**14,968**	**9.04**	**1,015**	7,055	5.63	298
Total commercial and commercial real estate	**339,241**	**4.00**	**10,151**	162,391	6.05	7,358
Consumer:						
Real estate 1-4 family first mortgage	**240,409**	**5.51**	**9,926**	74,064	6.77	3,761
Real estate 1-4 family junior lien mortgage	**108,094**	**4.81**	**3,894**	75,220	6.78	3,820
Credit card	**23,236**	**12.16**	**2,118**	19,256	12.11	1,749
Other revolving credit and installment	**91,240**	**6.60**	**4,502**	54,949	8.84	3,637
Total consumer	**462,979**	**5.90**	**20,440**	223,489	7.74	12,967
Foreign	**30,856**	**4.02**	**929**	7,382	10.72	592

Total loans (5)	**833,076**	**5.05**	**31,520**	393,262	7.10	20,917
Other	**6,102**	**3.02**	**137**	1,995	4.55	68
Total earning assets	**$ 1,100,332**	**5.21%**	**$ 43,116**	515,345	6.81%	$ 26,361
Funding sources						
Deposits:						
Interest-bearing checking	**$ 73,195**	**0.14%**	**$ 77**	5,399	1.31%	$ 53
Market rate and other savings	**339,081**	**0.42**	**1,072**	162,792	1.45	1,765
Savings certificates	**150,607**	**1.14**	**1,280**	38,907	3.23	940
Other time deposits	**21,794**	**1.97**	**321**	6,163	2.87	133
Deposits in foreign offices	**50,907**	**0.29**	**111**	49,192	2.13	785
Total interest-bearing deposits	**635,584**	**0.60**	**2,861**	262,453	1.87	3,676
Short-term borrowings	**58,447**	**0.50**	**217**	67,714	2.51	1,274
Long-term debt	**238,909**	**2.55**	**4,568**	101,668	3.71	2,825
Other liabilities	**4,675**	**3.50**	**122**			
Total interest-bearing liabilities	**937,615**	**1.11**	**7,768**	431,835	2.40	7,775
Portion of noninterest-bearing funding sources	**162,717**			83,510		
Total funding sources	**$ 1,100,332**	**0.94**	**7,768**	515,345	2.01	7,775
Net interest margin and net interest income on a taxable-equivalent basis (6)		**4.27%**	**$ 35,348**		4.80%	$ 18,586
Noninterest-earning assets						
Cash and due from banks	**$ 19,218**			11,182		
Goodwill	**23,964**			13,289		
Other	**126,557**			54,901		
Total noninterest-earning assets	**$ 169,739**			79,372		
Noninterest-bearing funding sources						
Deposits	**$ 169,187**			86,676		
Other liabilities	**49,249**			27,973		
Total equity	**114,020**			48,233		
Noninterest-bearing funding sources used to fund earning assets	**(162,717)**			(83,510)		
Net noninterest-bearing funding sources	**$ 169,739**			79,372		
Total assets	**$ 1,270,071**			594,717		

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NONINTEREST INCOME

(in millions)	Quarter ended Sept. 30, 2009	2008	Nine months ended Sept. 30, 2009	2008
Service charges on deposit accounts	**$ 1,478**	839	**4,320**	2,387
Trust and investment fees:				
Trust, investment and IRA fees	**989**	549	**2,550**	1,674
Commissions and all other fees	**1,513**	189	**4,580**	589
Total trust and investment fees	**2,502**	738	**7,130**	2,263
Card fees	**946**	601	**2,722**	1,747
Other fees:				
Cash network fees	**60**	48	**176**	143
Charges and fees on loans	**453**	266	**1,326**	765
All other fees	**437**	238	**1,312**	654
Total other fees	**950**	552	**2,814**	1,562
Mortgage banking:				
Servicing income, net	**1,873**	525	**3,469**	1,019
Net gains on mortgage loan origination/sales activities	**1,125**	276	**4,910**	1,419
All other	**69**	91	**238**	282
Total mortgage banking	**3,067**	892	**8,617**	2,720
Insurance	**468**	439	**1,644**	1,493
Net gains from trading activities	**622**	65	**2,158**	684
Net gains (losses) on debt securities available for sale	**(40)**	84	**(237)**	316
Net gains (losses) from equity investments	**29**	(509)	**(88)**	(149)
Operating leases	**224**	102	**522**	365
All other	**536**	193	**1,564**	593
Total	**$ 10,782**	3,996	**31,166**	13,981

We recently announced policy changes that will help customers limit overdraft and returned item fees. We currently estimate that these changes will reduce our 2010 fee revenue by approximately $300 million (after tax), although the actual impact could vary due to a variety of factors including implementation timing and customer behavior in response to the policy changes.

We earn 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. At September 30, 2009, these assets totaled $1.8 trillion, including $529 billion from Wachovia, up from $1.2 trillion at September 30, 2008. Trust, investment and IRA fees are primarily based on a tiered scale relative to the market value of the assets under management or administration. These fees increased to $989 million in third quarter 2009 from $549 million a year ago.

We receive commissions and other fees for providing services to full-service and discount brokerage customers. These fees increased to $1.5 billion in third quarter 2009 from $189 million a year ago. These fees include transactional commissions, which are based on the number of transactions executed at the customer s direction, and asset-based fees, which are based on the market value of the customer s assets. At September 30, 2009, client assets totaled $1.1 trillion, including $951 billion from Wachovia, compared with $123 billion at September 30, 2008. Commissions and other fees also include fees from investment banking activities including equity and bond underwriting.

Card fees increased to $946 million in third quarter 2009 from $601 million a year ago, predominantly due to $315 million in card fees from the Wachovia portfolio.

Mortgage banking noninterest income was $3.1 billion in third quarter 2009, compared with $892 million a year ago. Net gains on mortgage loan origination/sales activities of $1.1 billion in third quarter 2009 were up from $276 million a year ago. Business performance remained strong in third quarter 2009,

reflecting a higher level of refinance activity due to the low interest rate environment, with residential real estate originations of $96 billion in third quarter 2009 compared with $51 billion a year ago. The 1-4 family first mortgage unclosed pipeline was $62 billion at September 30, 2009, $71 billion at December 31, 2008, and $41 billion at September 30, 2008. For additional detail, see the Asset/Liability and Market Risk Management Mortgage Banking Interest Rate and Market Risk, section and Note 8 (Mortgage Banking Activities) and Note 12 (Fair Values of Assets and Liabilities) to Financial Statements in this Report.

Net gains on mortgage loan origination/sales activities include charges to increase the mortgage repurchase reserve. Mortgage loans are repurchased based on standard representations and warranties. A $146 million increase in the repurchase reserve was recorded in the third quarter 2009, due to higher defaults, anticipated higher repurchase demands and overall deterioration in the market. If the current difficult economic cycle worsens, the residential mortgage business could continue to have increased default rates and investor repurchase requests, lower repurchase request appeals success rates and higher loss severity on repurchases, causing future increases in the repurchase reserve.

Within mortgage banking noninterest income, servicing income includes both changes in the fair value of MSRs during the period as well as changes in the value of derivatives (economic hedges) used to hedge the MSRs. Net servicing income in third quarter 2009 included a $1.5 billion combined market-related valuation gain on MSRs and economic hedges recorded in earnings (consisting of a $2.1 billion decrease in the fair value of the MSRs offset by $3.6 billion hedge gain) and in third quarter 2008 included a $75 million gain ($546 million decrease in the fair value of MSRs offset by $621 million hedge gain). The net gain in the current quarter was largely due to hedge-carry income, which reflected the current low short-term interest rate environment. The low short-term interest rate environment is expected to continue into fourth quarter 2009. Our portfolio of loans serviced for others was $1.88 trillion at September 30, 2009, and $1.86 trillion at December 31, 2008. At September 30, 2009, the ratio of MSRs to related loans serviced for others was 0.83%.

Income from trading activities was $622 million and $2.2 billion in the third quarter and first nine months of 2009, respectively, up from $65 million and $684 million, respectively, a year ago.

Net investment losses (debt and equity) totaled $11 million and $325 million in the third quarter and first nine months of 2009, respectively, and included OTTI write-downs of $396 million and $1.4 billion, respectively. Net investment losses of $425 million for third quarter 2008 and gains of $167 million for the first nine months of 2008 included OTTI write-downs of $893 million and $1.1 billion, respectively.

Net losses on debt securities available for sale were $40 million and $237 million in the third quarter and first nine months of 2009, compared with net gains of $84 million and $316 million, respectively, a year ago. Net gains from equity investments were $29 million in third quarter 2009, compared with losses of $509 million a year ago. Net losses from equity investments were $88 million in the first nine months of 2009 and $149 million in the first nine months of 2008, which included the $334 million gain from our ownership interest in Visa, which completed its initial public offering in March 2008.

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NONINTEREST EXPENSE

(in millions)	Quarter ended Sept. 30, 2009	2008	Nine months ended Sept. 30, 2009	2008
Salaries	**$ 3,428**	2,078	**10,252**	6,092
Commission and incentive compensation	**2,051**	555	**5,935**	2,005
Employee benefits	**1,034**	486	**3,545**	1,666
Equipment	**563**	302	**1,825**	955
Net occupancy	**778**	402	**2,357**	1,201
Core deposit and other intangibles	**642**	47	**1,935**	139
FDIC and other deposit assessments	**228**	37	**1,547**	63
Outside professional services	**489**	206	**1,350**	589
Insurance	**208**	144	**734**	511
Postage, stationery and supplies	**211**	136	**701**	415
Outside data processing	**251**	122	**745**	353
Travel and entertainment	**151**	113	**387**	330
Foreclosed assets	**243**	99	**678**	298
Contract services	**254**	88	**726**	300
Operating leases	**52**	90	**183**	308
Advertising and promotion	**160**	96	**396**	285
Telecommunications	**142**	78	**464**	238
Operating losses	**117**	63	**448**	46
All other	**682**	359	**1,991**	994
Total	**$ 11,684**	5,501	**36,199**	16,788

The increase in noninterest expense to $11.7 billion in third quarter 2009 from a year ago was predominantly due to the acquisition of Wachovia, which resulted in an expanded geographic platform and capabilities in businesses such as retail brokerage, asset management and investment banking, which, like mortgage banking, typically include higher revenue-based incentive expense than the more traditional banking businesses. Noninterest expense included $249 million and $699 million of merger-related costs for the third quarter and first nine months of 2009, respectively. FDIC and other deposit assessments, which include additional assessments related to the FDIC Transaction Account Guarantee Program in 2009, were $228 million in third quarter 2009 and $1.5 billion for the first nine months of 2009, including a second quarter 2009 FDIC special assessment of $565 million. See the Liquidity and Funding section in this Report for additional information. Pension cost in the third quarter and first nine months of 2009 reflected actions related to the freezing of the Wells Fargo and Wachovia pension plans that lowered pension cost by approximately $187 million for third quarter 2009, and $312 million for the first nine months of 2009. These actions are expected to reduce pension cost in fourth quarter 2009 by approximately $188 million. See Note 14 (Employee Benefits) to Financial Statements in this Report for additional information. Noninterest expense included $100 million and $306 million of additional insurance reserve at our captive mortgage reinsurance operation for the third quarter and first nine months of 2009, respectively.

INCOME TAX EXPENSE

Our effective income tax rate was 29.5% in third quarter 2009, down from 30.8% in third quarter 2008, and 31.7% for the first nine months of 2009, down from 32.9% for the first nine months of 2008. The decrease was primarily due to higher tax-exempt income, tax credits, tax settlements, and statute expirations partially offset by increased tax expense

(with a comparable increase in interest income) associated with the purchase accounting for leveraged leases. Effective January 1, 2009, we adopted new accounting guidance that changes the way noncontrolling interests are presented in the income statement such that the consolidated income statement includes amounts from both Wells Fargo interests and the noncontrolling interests. As a result, our effective tax

rate is calculated by dividing income tax expense by income before income tax expense less the net income from noncontrolling interests.

OPERATING SEGMENT RESULTS

Wells Fargo defines its operating segments by product type and customer segment. As a result of the combination of Wells Fargo and Wachovia, in first quarter 2009 management realigned its business segments into the following three lines of business: Community Banking; Wholesale Banking; and Wealth, Brokerage and Retirement. Our management accounting process measures the performance of the operating segments based on our management structure and is not necessarily comparable with similar information for other financial services companies. We revised prior period information to reflect the first quarter 2009 realignment of our operating segments; however, because the acquisition was completed on December 31, 2008, Wachovia s results are not included in the income statement or in average balances for periods prior to 2009. The Wachovia acquisition was material to us, and the inclusion of results from Wachovia s businesses in our 2009 financial statements is a material factor in the changes in our results compared with prior year periods. For a more complete description of our operating segments, including additional financial information and the underlying management accounting process, see Note 16 (Operating Segments) to Financial Statements in this Report.

Community Banking offers a complete line of diversified financial products and services for consumers and small businesses including investment, insurance and trust services in 39 states and D.C., and mortgage and home equity loans in all 50 states and D.C. Wachovia added expanded product capability as well as expanded channels to better serve our customers. In addition, Community Banking includes Wells Fargo Financial.

Community Banking net income increased to $2.7 billion in third quarter 2009 from $2.0 billion in second quarter 2009, and $1.5 billion a year ago. Net income increased to $6.5 billion for the first nine months of 2009, up from $4.2 billion a year ago. The year-over-year growth in net income for Community Banking was largely due to the addition of Wachovia businesses, as well as double-digit growth in legacy Wells Fargo, driven by strong balance sheet growth and mortgage banking income. Revenue increased to $15.1 billion in the current quarter from $14.8 billion in second quarter 2009 and $8.5 billion a year ago. Revenue was $43.9 billion in the first nine months of 2009, up from $25.6 billion a year ago. Net interest income was $8.7 billion in third quarter 2009, flat from second quarter 2009 and up from $5.3 billion a year ago. Average loans of $534.7 billion in third quarter 2009 were down slightly from $540.7 billion in second quarter 2009, and up from $287.1 billion a year ago. Average core deposits of $530.3 billion in third quarter 2009, were down slightly from $543.9 billion in second quarter 2009 and up from $252.8 billion a year ago. The year-over-year increase in core deposits was due to the Wachovia acquisition, as well as double-digit growth in legacy Wells Fargo. Noninterest income increased to $6.4 billion in third quarter 2009 from $6.0 billion in second quarter 2009, driven by continued strength in mortgage banking and strong growth in deposit service charges and card fees, and from $3.2 billion a year ago. Noninterest expense of $6.8 billion in third quarter 2009, was down from $7.7 billion in second quarter 2009, driven by higher second quarter 2009 FDIC deposit insurance assessments as well as expense reductions due to Wachovia merger-related cost saves, and up from $4.0 billion a year ago. The provision for credit losses increased $308 million to $4.6 billion in third quarter 2009, including a $236 million credit reserve build, from $4.3 billion in second quarter 2009, which included a $479 million credit reserve build, and $2.2 billion a year ago.

Wholesale Banking provides financial solutions to businesses across the United States with annual sales generally in excess of $10 million and to financial institutions globally. Products include middle market banking, corporate banking, commercial real estate, treasury management, asset-based lending, insurance brokerage, foreign exchange, correspondent banking, trade services, specialized lending, equipment

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finance, corporate trust, investment banking, capital markets, and asset management. Wachovia added expanded product capabilities across the segment, including investment banking, mergers and acquisitions, equity trading, equity structured products, fixed-income sales and trading, and equity and fixed income research.

Wholesale Banking net income of $598 million in third quarter 2009 was down from $1.1 billion in second quarter 2009 and up from $103 million a year ago. Net income increased to $2.8 billion for the first nine months of 2009, up from $1.2 billion a year ago. The year-over-year growth in net income for Wholesale Banking was largely due to the addition of Wachovia businesses. Revenue increased to $4.9 billion and $15.1 billion in the third quarter and first nine months of 2009, respectively, from $1.7 billion and $6.3 billion for the same periods a year ago. Revenue decreased $322 million from $5.2 billion in second quarter 2009, primarily due to strength in investment banking and capital markets revenue in second quarter 2009, as well as insurance revenue seasonality. Net interest income was $2.5 billion in third quarter 2009, flat from second quarter 2009 and up from $1.1 billion a year ago. The year-over-year growth in average assets was largely due to the addition of the Wachovia businesses. Average loans were $247.0 billion in third quarter 2009, down from $263.5 billion in second quarter 2009, and up from $116.3 billion a year ago. Average core deposits increased to $146.9 billion in third quarter 2009 from $138.1 billion in second quarter 2009 and $64.4 billion a year ago. Noninterest income was $2.4 billion in third quarter 2009, down from $2.8 billion in second quarter 2009 and up from $631 million a year ago. Noninterest expense was $2.6 billion in third quarter 2009, down from $2.8 billion in second quarter 2009 and up from $1.3 billion a year ago. The provision for credit losses increased $623 million to $1.4 billion in third quarter 2009, including a $627 million build to reserves for the wholesale portfolio, up from $738 million in second quarter 2009, which included a $162 million credit reserve build, and $294 million a year ago.

Wealth, Brokerage and Retirement provides a full range of financial advisory services to clients. Wealth Management provides affluent and high-net-worth clients with a complete range of wealth management solutions including financial planning, private banking, credit, investment management, trust and estate services, business succession planning and charitable services along with bank-based brokerage services through Wells Fargo Advisors and Wells Fargo Investments, LLC. Family Wealth provides family-office services to ultra-high-net-worth clients and is one of the largest multi-family financial office practices in the United States. Retail Brokerage s financial advisors serve customers advisory, brokerage and financial needs as part of one of the largest full-service brokerage firms in the United States. Retirement provides retirement services for individual investors and is a national leader in 401(k) and pension record keeping. The addition of Wachovia in first quarter 2009 added the following businesses to this operating segment: Wachovia Securities (retail brokerage), Wachovia Wealth Management, including its family wealth business and Wachovia s retirement and reinsurance business.

Wealth, Brokerage and Retirement net income was $244 million in third quarter 2009, down from $363 million in second quarter 2009, and up from $112 million a year ago. Net income increased to $866 million for the first nine months of 2009, up from $316 million a year ago. The year-over-year growth in net income and average assets for the segment was due to the addition of Wachovia businesses. Revenue of $3.0 billion was flat from second quarter 2009 as the strong equity market recovery led to increases in client assets across the brokerage, wealth and retirement businesses, driving solid revenue growth, partially offset by lower realized gains on sales of securities available for sale in the brokerage business. Revenue increased to $3.0 billion and $8.6 billion in the third quarter and first nine months of 2009, respectively, from $681 million and $2.0 billion for the same periods a year ago. Net interest income was $743 million in third quarter 2009 and $764 million in second quarter 2009, up from $223 million a year ago. Average loans were $45.4 billion in third quarter 2009, flat from second quarter 2009 and up from $15.9 billion a year ago. The year-over-year growth in average loans was largely due to the addition of the Wachovia businesses. Noninterest income of $2.2 billion in third quarter 2009 was

flat from second quarter 2009 and up from $458 million a year ago. Noninterest expense of $2.3 billion in third quarter 2009 was flat from second quarter 2009 and up from $498 million a year ago. The provision for credit losses was $234 million in third quarter 2009, up from $115 million from second quarter 2009, largely reflecting a credit reserve build of $137 million due to higher loss rates, and up from $3 million a year ago.

BALANCE SHEET ANALYSIS

SECURITIES AVAILABLE FOR SALE

Securities available for sale consist of both debt and marketable equity securities. We hold debt securities available for sale primarily for liquidity, interest rate risk management and long-term yield enhancement. Accordingly, this portfolio consists primarily of very liquid, high-quality federal agency debt and privately issued mortgage-backed securities. At September 30, 2009, we held $177.9 billion of debt securities available for sale, with net unrealized gains of $5.8 billion, compared with $145.4 billion at December 31, 2008, with net unrealized losses of $9.8 billion. We also held $5.9 billion of marketable equity securities available for sale at September 30, 2009, with net unrealized gains of $806 million, compared with $6.1 billion at December 31, 2008, with net unrealized losses of $160 million. Following application of purchase accounting to the Wachovia portfolio, the net unrealized losses in cumulative OCI, a component of common equity, at December 31, 2008, related entirely to the legacy Wells Fargo portfolio.

At September 30, 2009, the net unrealized gains on securities available for sale were $6.6 billion, up from net unrealized losses of $9.9 billion at December 31, 2008, due to general decline in long-term yields and narrowing of credit spreads.

We analyze securities for OTTI on a quarterly basis, or more often if a potential loss-triggering event occurs. The initial indication of OTTI for both debt and equity securities is a decline in the market value below the amount recorded for an investment, and the severity and duration of the decline. In determining whether an impairment is other than temporary, we consider the length of time and the extent to which the market value has been below cost, recent events specific to the issuer, including investment downgrades by rating agencies and economic conditions within its industry, and whether it is more likely than not that we will be required to sell the security before a recovery in value.

For marketable equity securities, in addition to the above factors, we also consider the issuer s financial condition, capital strength and near-term prospects. For debt securities and for certain perpetual preferred securities that are treated as debt securities for the purpose of OTTI analysis, we also consider the cause of the price decline (general level of interest rates and industry- and issuer-specific factors), the issuer s financial condition, near-term prospects and current ability to make future payments in a timely manner, the issuer s ability to service debt, any change in agency ratings at evaluation date from acquisition date and any likely imminent action. For asset-backed securities, we consider the credit performance of the underlying collateral, including delinquency rates, cumulative losses to date, and any remaining credit enhancement compared to expected credit losses of the security.

For debt securities, we recognize OTTI in accordance with new provisions in FASB ASC 320, *Investments Debt and Equity Securities*. We early adopted this new accounting guidance for recognizing OTTI on debt securities on January 1, 2009. Under this guidance, we separate the amount of the OTTI into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between a security s amortized cost basis and the present value of expected future cash flows discounted at the security s effective interest rate. The amount due to all other factors is recognized in OCI.

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Of the third quarter 2009 OTTI write-downs of $396 million, $273 million related to debt securities and $123 million to equity securities. Of the OTTI write-downs of $1,375 million in the first nine months of 2009, $850 million related to debt securities and $525 million related to equity securities.

At September 30, 2009, we had approximately $7 billion of securities, primarily municipal bonds that are guaranteed against loss by bond insurers. These securities are primarily investment grade and were generally underwritten consistent with our own investment standards prior to the determination to purchase, without relying on the bond insurer s guarantee. These securities will continue to be monitored as part of our ongoing impairment analysis of our securities available for sale, but are expected to perform, even if the rating agencies reduce the credit ratings of the bond insurers.

The weighted-average expected maturity of debt securities available for sale was 4.9 years at September 30, 2009. Since 75% of this portfolio is mortgage-backed securities, the expected remaining maturity may differ from contractual maturity because borrowers may have the right to prepay obligations before the underlying mortgages mature. The estimated effect of a 200 basis point increase or decrease in interest rates on the fair value and the expected remaining maturity of the mortgage-backed securities available for sale is shown below.

MORTGAGE-BACKED SECURITIES

(in billions)	Fair value	Net unrealized gain (loss)	Expected remaining maturity
At September 30, 2009	$ 132.9	3.6	3.7
At September 30, 2009, assuming a 200 basis point:			
Increase in interest rates	123.4	(5.9)	5.2
Decrease in interest rates	139.0	9.7	2.7

See Note 4 (Securities Available for Sale) to Financial Statements in this Report for securities available for sale by security type.

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LOAN PORTFOLIO

	September 30, 2009			December 31, 2008		
(in millions)	**PCI loans**	**All other loans**	**Total**	PCI loans	All other loans	Total
Commercial and commercial real estate:						
Commercial	**$ 2,407**	**167,203**	**169,610**	4,580	197,889	202,469
Real estate mortgage	**5,950**	**97,492**	**103,442**	7,762	95,346	103,108
Real estate construction	**4,250**	**27,469**	**31,719**	4,503	30,173	34,676
Lease financing		**14,115**	**14,115**		15,829	15,829
Total commercial and commercial real estate	**12,607**	**306,279**	**318,886**	16,845	339,237	356,082
Consumer:						
Real estate 1-4 family first mortgage	**39,538**	**193,084**	**232,622**	39,214	208,680	247,894
Real estate 1-4 family junior lien mortgage	**425**	**104,113**	**104,538**	728	109,436	110,164
Credit card		**23,597**	**23,597**		23,555	23,555
Other revolving credit and installment		**90,027**	**90,027**	151	93,102	93,253
Total consumer	**39,963**	**410,821**	**450,784**	40,093	434,773	474,866
Foreign	**1,768**	**28,514**	**30,282**	1,859	32,023	33,882
Total loans	**$ 54,338**	**745,614**	**799,952**	58,797	806,033	864,830

A discussion of average loan balances is included in Earnings Performance Net Interest Income on page 17 and a comparative schedule of average loan balances is included in the table on pages 18 and 19.

In the first nine months of 2009, we refined certain of our preliminary purchase accounting adjustments based on additional information as of December 31, 2008. This additional information resulted in a net increase to the unpaid principal balance of purchased credit-impaired (PCI) loans of $2.5 billion, consisting of a $1.7 billion decrease in commercial and commercial real estate loans and a $4.2 billion increase in consumer loans ($2.7 billion of which related to Pick-a-Pay loans).

The refinements resulted in a net increase to the nonaccretable difference of $3.8 billion, due to the addition of more loans as discussed above and refinement of the nonaccretable estimates, and a net increase to the accretable yield, which is a premium, of $1.9 billion. Of the net increase in the nonaccretable difference, $300 million related to commercial and commercial real estate loans, and $3.5 billion to consumer loans ($2.2 billion of which related to Pick-a-Pay loans). Of the net increase in the accretable yield, which reflects changes in the amount and timing of estimated cash flows, the discount related to commercial and commercial real estate loans increased by $191 million, and the premium related to consumer loans increased by $2.1 billion ($2.0 billion of which related to Pick-a-Pay loans). The effect on goodwill of these adjustments amounted to a net increase in goodwill of $1.9 billion (pre tax).

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The nonaccretable difference was established in purchase accounting for PCI loans to absorb losses. The nonaccretable difference can change when it is no longer needed to absorb future expected losses, or when losses that otherwise would be recorded as charge-offs are absorbed. Amounts absorbed by the nonaccretable difference do not affect the income statement or the allowance for credit losses.

CHANGES IN NONACCRETABLE DIFFERENCE FOR PCI LOANS

The following table shows the changes in the nonaccretable difference related to principal cash flows.

(in millions)	Pick-a-Pay	Other consumer	Commercial, CRE and foreign	Total
Balance at December 31, 2008, with refinements	$ (26,485)	(4,082)	(10,378)	(40,945)
Release of nonaccretable difference due to:				
Loans resolved by payment in full			194	194
Loans resolved by sales to third parties		85	28	113
Loans with improving cash flows reclassified to accretable yield			21	21
Use of nonaccretable difference due to:				
Losses from loan resolutions and write-downs (1)	8,320	1,796	3,552	13,668
Balance at September 30, 2009	**$ (18,165)**	**(2,201)**	**(6,583)**	**(26,949)**

(1) Use of nonaccretable difference through June 30, 2009, was $8.5 billion (including $5.1 billion for Pick-a-Pay loans); revised from second quarter to include all losses due to resolution of loans and write-downs.

For further detail on PCI loans, see Note 1 (Summary of Significant Accounting Policies Loans) to Financial Statements in the 2008 Form 10-K and Note 5 (Loans and Allowance for Credit Losses) to Financial Statements in this Report.

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DEPOSITS

(in millions)	**Sept. 30, 2009**	Dec. 31, 2008
Noninterest-bearing	**$ 165,260**	150,837
Interest-bearing checking	**60,214**	72,828
Market rate and other savings	**371,298**	306,255
Savings certificates	**119,012**	182,043
Foreign deposits (1)	**32,129**	33,469
Core deposits	**747,913**	745,432
Other time deposits	**16,691**	28,498
Other foreign deposits	**32,144**	7,472
Total deposits	**$ 796,748**	781,402

(1) Reflects Eurodollar sweep balances included in core deposits.

Deposits at September 30, 2009, totaled $796.7 billion, up from $781.4 billion at December 31, 2008. Comparative detail of average deposit balances is provided on pages 18 and 19 of this Report. Total core deposits were $747.9 billion at September 30, 2009, up $2.5 billion from December 31, 2008. High-rate certificates of deposit (CDs) of $38 billion at Wachovia matured in third quarter 2009 and were replaced by $22 billion in checking, savings or lower-cost CDs. We continued to gain new deposit customers and deepen our relationship with existing customers.

OFF-BALANCE SHEET ARRANGEMENTS

In the ordinary course of business, we engage in financial transactions that are not recorded in the balance sheet, or may be recorded in the balance sheet in amounts that are different from the full contract or notional amount of the transaction. These transactions are designed to (1) meet the financial needs of customers, (2) manage our credit, market or liquidity risks, (3) diversify our funding sources, and/or (4) optimize capital. These are described below as off-balance sheet transactions with unconsolidated entities, and as guarantees and certain contingent arrangements. See discussion of FAS 166 and FAS 167 in the Current Accounting Developments section in this Report.

OFF-BALANCE SHEET TRANSACTIONS WITH UNCONSOLIDATED ENTITIES

In the normal course of business, we enter into various types of on- and off-balance sheet transactions with special purpose entities (SPEs), which are corporations, trusts or partnerships that are established for a limited purpose. Historically, the majority of SPEs were formed in connection with securitization transactions. In a securitization transaction, assets from our balance sheet are transferred to an SPE, which then issues to investors various forms of interests in those assets and may also enter into derivative transactions. In a securitization transaction, we typically receive cash and/or other interests in an SPE as proceeds for the assets we transfer. Also, in certain transactions, we may retain the right to service the transferred receivables and to repurchase those receivables from the SPE if the outstanding balance of the receivables falls to a level where the cost exceeds the benefits of servicing such receivables.

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In connection with our securitization activities, we have various forms of ongoing involvement with SPEs, which may include:

- underwriting securities issued by SPEs and subsequently making markets in those securities;
- providing liquidity to support short-term obligations of SPEs issued to third party investors;
- providing credit enhancement to securities issued by SPEs or market value guarantees of assets held by SPEs through the use of letters of credit, financial guarantees, credit default swaps and total return swaps;
- entering into other derivative contracts with SPEs;
- holding senior or subordinated interests in SPEs;
- acting as servicer or investment manager for SPEs; and
- providing administrative or trustee services to SPEs.

The SPEs we use are QSPEs, which are not consolidated if the criteria described below are met, or VIEs. To qualify as a QSPE, an entity must be passive and must adhere to significant limitations on the types of assets and derivative instruments it may own and the extent of activities and decision making in which it may engage. For example, a QSPE s activities are generally limited to purchasing assets, passing along the cash flows of those assets to its investors, servicing its assets and, in certain transactions, issuing liabilities. Among other restrictions on a QSPE s activities, a QSPE may not actively manage its assets through discretionary sales or modifications.

A VIE is an entity that has either a total equity investment that is insufficient to permit the entity to finance its activities without additional subordinated financial support or whose equity investors lack the characteristics of a controlling financial interest. A VIE is consolidated by its primary beneficiary, which is the entity that, through its variable interests, absorbs the majority of a VIE s variability. A variable interest is a contractual, ownership or other interest that changes with fluctuations in the fair value of the VIE s net assets.

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The following table presents our significant continuing involvement with QSPEs and unconsolidated VIEs.
QUALIFYING SPECIAL PURPOSE ENTITIES AND UNCONSOLIDATED VARIABLE INTEREST ENTITIES

	September 30, 2009			December 31, 2008		
(in millions)	**Total entity assets**	**Carrying value**	**Maximum exposure to loss**	Total entity assets	Carrying value	Maximum exposure to loss
QSPEs						
Residential mortgage loan securitizations (1):						
Conforming (2) and GNMA	**$ 1,116,937**	**21,245**	**23,494**	1,008,824	21,496	22,569
Other/nonconforming	**280,304**	**9,291**	**9,593**	313,447	9,483	9,909
Commercial mortgage securitizations	**384,716**	**2,835**	**6,341**	355,267	3,060	6,376
Student loan securitizations	**2,675**	**167**	**167**	2,765	133	133
Auto loan securitizations	**2,723**	**157**	**157**	4,133	115	115
Other	**8,854**	**8**	**44**	11,877	71	1,576
Total QSPEs	**$ 1,796,209**	**33,703**	**39,796**	1,696,313	34,358	40,678
Unconsolidated VIEs						
Collateralized debt obligations (1)	**$ 58,280**	**14,200**	**17,543**	54,294	15,133	20,443
Wachovia administered ABCP (3) conduit	**6,536**		**6,667**	10,767		15,824
Asset-based finance structures	**18,366**	**10,444**	**11,026**	11,614	9,096	9,482
Tax credit structures	**27,636**	**3,837**	**4,506**	22,882	3,850	4,926
Collateralized loan obligations	**22,531**	**3,668**	**4,154**	23,339	3,326	3,881
Investment funds	**87,132**	**2,089**	**2,697**	105,808	3,543	3,690
Credit-linked note structures	**1,846**	**1,116**	**1,884**	12,993	1,522	2,303
Money market funds (4)	**7,469**	**(9)**	**41**	31,843	60	101
Other	**8,056**	**3,564**	**3,821**	1,832	3,806	4,699
Total unconsolidated VIEs	**$ 237,852**	**38,909**	**52,339**	275,372	40,336	65,349

(1) For December 31, 2008, certain balances related to QSPEs involving residential mortgage loan securitizations and VIEs involving collateralized debt

obligations have been revised to reflect current information.

(2) Conforming residential mortgage loan securitizations are those that are guaranteed by government-sponsored entites. We have concluded that conforming mortgages are not subject to consolidation under FAS 166 and FAS 167. See the Current Accounting Developments section in this Report for our estimate of the nonconforming mortgages that may potentially be consolidated under FAS 166 and FAS 167.

(3) Asset-backed commercial paper.

(4) At September 30, 2009, excludes previously supported money market funds, to which the Company no longer provides non-contractual financial support.

The table above does not include SPEs and unconsolidated VIEs where our only involvement is in the form of investments in trading securities, investments in securities available for sale or loans underwritten by third parties, or administrative or trustee services. Also not included are investments accounted for in accordance with the American Institute of Certified Public Accountants (AICPA) Investment Company Audit Guide, investments accounted for under the cost method and investments accounted for under the equity method.

In the table above, the columns titled Total entity assets represent the total assets of unconsolidated SPEs. Carrying value is the amount in our consolidated balance sheet related to our involvement with the unconsolidated SPEs. Maximum exposure to loss from our involvement with off-balance sheet entities, which is a required disclosure under GAAP, is determined as the carrying value of our involvement with off-balance sheet (unconsolidated) VIEs plus the remaining undrawn liquidity and lending commitments, the notional amount of net written derivative contracts, and the notional amount of other commitments and guarantees. It represents the estimated loss that would be incurred under an assumed, although we believe extremely remote, hypothetical circumstance where the value of our interests and any associated collateral declines to zero, without any consideration of recovery or offset from any economic hedges. Accordingly, this required disclosure is not an indication of expected loss.

For more information on securitizations, including sales proceeds and cash flows from securitizations, see Note 7 (Securitizations and Variable Interest Entities) to Financial Statements in this Report.

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RISK MANAGEMENT

All financial institutions must manage and control a variety of risks that can significantly affect financial performance. Key among them are credit, asset/liability and market risk.

CREDIT RISK MANAGEMENT PROCESS

Our credit risk management process is governed centrally, but provides for decentralized management and accountability by our lines of business. Our overall credit process includes comprehensive credit policies, judgmental or statistical credit underwriting, frequent and detailed risk measurement and modeling, extensive credit training programs, and a continual loan review and audit process. In addition, regulatory examiners review and perform detailed tests of our credit underwriting, loan administration and allowance processes.

We continually evaluate and modify our credit policies to address unacceptable levels of risk as they are identified. Accordingly, from time to time, we designate certain portfolios and loan products as non-strategic or high risk to limit or cease their continued origination and to specially monitor their loss potential. As an example, during the current weak economic cycle we have significantly tightened bank-selected reduced documentation requirements as a precautionary measure and to substantially reduce third party originations due to the negative loss trends experienced in these channels.

A key to our credit risk management is utilizing a well controlled underwriting process, which we believe is appropriate for the needs of our customers as well as investors who purchase the loans or securities collateralized by the loans. We only approve applications and make loans if we believe the customer has the ability to repay the loan or line of credit according to all its terms. Our underwriting of loans collateralized by residential real property utilizes appraisals or automated valuation models (AVMs) to support property values. AVMs are computer-based tools used to estimate the market value of homes. AVMs are a lower-cost alternative to appraisals and support valuations of large numbers of properties in a short period of time. AVMs estimate property values based on processing large volumes of market data including market comparables and price trends for local market areas. The primary risk associated with the use of AVMs is that the value of an individual property may vary significantly from the average for the market area. We have processes to periodically validate AVMs and specific risk management guidelines addressing the circumstances when AVMs may be used. Generally, AVMs are only used in underwriting to support property values on loan originations where the loan amount is under $250,000. For underwriting residential property loans of $250,000 or more we require property visitation appraisals by qualified independent appraisers.

Measuring and monitoring our credit risk is an ongoing process that tracks delinquencies, collateral values, economic trends by geographic areas, loan-level risk grading for certain portfolios (typically commercial) and other indications of risk to loss. Our credit risk monitoring process is designed to enable early identification of developing risk to loss and to support our determination of an adequate allowance for loan losses. During the current economic cycle our monitoring and resolution efforts have focused on loan portfolios exhibiting the highest levels of risk including mortgage loans supported by real estate (both consumer and commercial), junior lien, commercial, credit card and subprime portfolios. The following analysis reviews each of these loan portfolios and their relevant concentrations and credit quality performance metrics in greater detail.

Commercial Real Estate

The commercial real estate (CRE) portfolio consists of both permanent commercial mortgage loans and construction loans. These CRE loans totaled $135.2 billion at September 30, 2009, which represented 17% of total loans. Construction loans totaled $31.7 billion at September 30, 2009, or 4% of total loans, and had an annualized quarterly loss rate of 3.01%. Permanent commercial real estate loans totaled $103.4 billion at September 30, 2009, or 13% of total loans, and had an annualized quarterly loss rate of 0.80%. The portfolio is diversified both geographically and by product type. The largest geographic concentrations are found in California and Florida, which represented 21% and 11% of the total commercial real estate portfolio, respectively, at September 30, 2009. By property type, the largest concentrations are owner-occupied and office buildings, which represented 32% and 22% of the population, respectively, at September 30, 2009.

At legacy Wells Fargo our underwriting of CRE loans has been focused primarily on cash flows and creditworthiness, not solely collateral valuations. Our legacy Wells Fargo management team is overseeing and managing the CRE loans acquired from Wachovia, which have effectively doubled the size of this portfolio. At merger closing, we determined that $19.3 billion of Wachovia CRE loans needed to be accounted for as PCI loans and we recorded an impairment write-down of $7.0 billion in our purchase accounting, which represented a 37% write-down of the PCI loans included in the CRE loan portfolio. To identify and manage newly emerging problem CRE loans we employ a high level of surveillance and regular customer interaction to understand and manage the risks associated with these assets, including regular loan reviews and appraisal updates. As issues are identified, management is engaged and dedicated workout groups are in place to manage problem assets.

The following table summarizes CRE loans by state and product type with the related nonaccrual totals. At September 30, 2009, the highest concentration of non-PCI CRE loans by state is $27.0 billion in California, about double the next largest state concentration, and the related nonaccrual loans totaled about $1.7 billion, or 6.2%. Office buildings at $28.2 billion of non-PCI loans are the largest property type concentration, nearly double the next largest, and the related nonaccrual loans totaled $0.7 billion, or 2.6%. Of commercial real estate mortgage loans (excluding construction loans), 42% related to owner-occupied properties at September 30, 2009. In aggregate, nonaccrual loans totaled 4.5% of the non-PCI outstanding balance at September 30, 2009, which is up from 3.6% at June 30, 2009.

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COMMERCIAL REAL ESTATE LOANS BY STATE AND PROPERTY TYPE

	September 30, 2009					
	Real estate mortgage		Real estate construction		Total	
(in millions)	Oustanding balance (1)	Nonaccrual loans	Oustanding balance (1)	Nonaccrual loans	Oustanding balance (1)	Nonaccrual loans
By state:						
PCI loans:						
Florida	$ 1,090		954		2,044	
California	1,195		172		1,367	
North Carolina	345		549		894	
Georgia	413		450		863	
Virginia	442		310		752	
Other	2,465		1,815		4,280(2)	
Total PCI loans	$ 5,950		4,250		10,200	
All other loans:						
California	$ 22,115	875	4,886	805	27,001	1,680
Florida	10,954	425	2,297	264	13,251	689
Texas	6,837	121	2,818	232	9,655	353
North Carolina	5,636	122	1,554	154	7,190	276
Georgia	4,449	137	951	105	5,400	242
Virginia	3,633	47	1,606	102	5,239	149
New York	3,720	50	1,181	17	4,901	67
Arizona	3,445	142	1,176	190	4,621	332
New Jersey	3,060	89	644	16	3,704	105
Colorado	2,104	58	951	88	3,055	146
Other	31,539	790	9,405	738	40,944(3)	1,528
Total all other loans	$ 97,492	2,856	27,469	2,711	124,961	5,567
Total	$ 103,442	2,856	31,719	2,711	135,161	5,567
By property:						
PCI loans:						
Apartments	$ 1,275		984		2,259	
Office buildings	1,756		222		1,978	
1-4 family land	648		1,014		1,662	
1-4 family structure	150		740		890	
Retail (excluding shopping center)	510		365		875	
Other	1,611		925		2,536	

Total PCI loans	$ 5,950		4,250		10,200	
All other loans:						
Office buildings	$ 25,026	606	3,205	139	28,231	745
Industrial/warehouse	13,913	354	1,105	11	15,018	365
Real estate other	13,289	468	996	73	14,285	541
Retail (excluding shopping center)	11,035	544	1,309	106	12,344	650
Apartments	7,615	213	4,492	216	12,107	429
Land (excluding 1-4 family)	3,252	123	6,431	456	9,683	579
Shopping center	5,982	78	2,514	151	8,496	229
Hotel/motel	5,091	67	1,165	93	6,256	160
1-4 family structure	1,273	68	2,558	669	3,831	737
1-4 family land	813	130	2,926	744	3,739	874
Other	10,203	205	768	53	10,971	258
Total all other loans	$ 97,492	2,856	27,469	2,711	124,961	5,567
Total	$ 103,442(4)	2,856	31,719	2,711	135,161	5,567

(1) For PCI loans amounts represent carrying value.
(2) Includes 42 states; no state had loans in excess of $675 million and $609 million at September 30 and June 30, 2009, respectively.
(3) Includes 40 states; no state had loans in excess of $3,047 million and $3,116 million at September 30 and June 30, 2009, respectively.
(4) Includes owner-occupied

real estate loans of $43.6 billion and $44.6 billion at September 30 and June 30, 2009, respectively.

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						June 30, 2009
	Real estate mortgage		Real estate construction		Total	
(in millions)	Oustanding balance (1)	Nonaccrual loans	Oustanding balance (1)	Nonaccrual loans	Oustanding balance (1)	Nonaccrual loans
By state:						
PCI loans:						
Florida	$ 1,169		1,047		2,216	
California	1,269		164		1,433	
North Carolina	369		558		927	
Georgia	410		473		883	
Virginia	450		357		807	
Other	2,159		1,696		3,855(2)	
Total PCI loans	$ 5,826		4,295		10,121	
All other loans:						
California	$ 21,809	601	5,215	802	27,024	1,403
Florida	11,113	278	2,465	207	13,578	485
Texas	6,738	71	2,917	214	9,655	285
North Carolina	5,797	83	1,605	47	7,402	130
Georgia	4,595	57	980	42	5,575	99
Virginia	3,520	55	1,613	82	5,133	137
New York	3,675	46	1,135		4,810	46
Arizona	3,309	121	1,335	132	4,644	253
New Jersey	3,168	70	676		3,844	70
Colorado	2,163	30	1,050	39	3,213	69
Other	31,941	931	9,952	645	41,893(3)	1,576
Total all other loans	$ 97,828	2,343	28,943	2,210	126,771	4,553
Total	$ 103,654	2,343	33,238	2,210	136,892	4,553
By property:						
PCI loans:						
Apartments	$ 1,596		207		1,803	
Office buildings	1,227		1,112		2,339	
1-4 family land	675		1,080		1,755	
1-4 family structure	155		868		1,023	
Land (excluding 1-4 family)	639		276		915	
Other	1,534		752		2,286	
Total PCI loans	$ 5,826		4,295		10,121	

All other loans:						
Office buildings	$ 25,094	382	3,299	87	28,393	469
Industrial/warehouse	14,069	205	1,163	6	15,232	211
Real estate other	12,848	352	1,089	84	13,937	436
Retail (excluding shopping center)	11,203	428	1,286	22	12,489	450
Apartments	7,473	181	4,490	105	11,963	286
Land (excluding 1-4 family)	3,474	65	6,562	359	10,036	424
Shopping center	5,888	296	2,604	150	8,492	446
Hotel/motel	4,911	43	1,308	59	6,219	102
1-4 family structure	1,299	23	2,989	599	4,288	622
1-4 family land	828	86	3,207	734	4,035	820
Other	10,741	282	946	5	11,687	287
Total all other loans	$ 97,828	2,343	28,943	2,210	126,771	4,553
Total	$ 103,654(4)	2,343	33,238	2,210	136,892	4,553

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Commercial Loans and Lease Financing

The following table summarizes commercial loans and lease financing by industry with the related nonaccrual totals. This portfolio has experienced less credit deterioration than our CRE portfolio as evidenced by its lower nonaccrual rate of 2.6% compared with 4.5% for the CRE portfolios. We believe this portfolio is well underwritten and is diverse in its risk with relatively even concentrations across several industries.

COMMERCIAL LOANS AND LEASE FINANCING BY INDUSTRY

	September 30, 2009		June 30, 2009	
(in millions)	**Outstanding balance (1)**	**Nonaccrual loans**	Outstanding balance (1)	Nonaccrual loans
PCI loans:				
Real estate investment trust	**$ 418**		523	
Media	**376**		378	
Leisure	**211**		112	
Residential construction	**152**		106	
Insurance	**132**		141	
Investment funds & trust	**125**		348	
Other	**993**(2)		1,059(2)	
Total PCI loans	**$ 2,407**		2,667	
All other loans:				
Financial institutions	**$ 11,468**	**469**	11,506	169
Oil and gas	**9,389**	**229**	10,091	188
Healthcare	**9,144**	**106**	9,767	79
Cyclical retailers	**8,458**	**93**	9,393	82
Industrial equipment	**8,409**	**136**	9,148	131
Food and beverage	**8,351**	**85**	8,578	47
Real estate other	**6,974**	**137**	7,366	78
Business services	**6,960**	**189**	7,548	124
Transportation	**6,505**	**42**	6,406	24
Public administration	**5,869**	**19**	6,160	22
Technology	**5,826**	**100**	6,065	25
Utilities	**5,799**	**15**	6,683	
Other	**88,166**(3)	**3,077**	95,214(3)	2,071
Total all other loans	**$ 181,318**	**4,697**	193,925	3,040
Total	**$ 183,725**	**4,697**	196,592	3,040

(1) For PCI loans amounts represent

carrying value.

(2) No other single category had loans in excess of $94 million and $100 million at September 30 and June 30, 2009, respectively.

(3) No other single category had loans in excess of $5,380 million and $5,747 million at September 30 and June 30, 2009, respectively.

Real Estate 1-4 Family Mortgage Loans

As part of the Wachovia acquisition, we acquired residential first and home equity loans that are very similar to the Wells Fargo core originated portfolio. We also acquired the Pick-a-Pay portfolio, which is composed primarily of option payment adjustable-rate mortgage and fixed-rate mortgage product. The option payment product making up 74% of this portfolio does contain the potential for negative amortization. Under purchase accounting for the Wachovia acquisition, the Pick-a-Pay loans with the highest probability of default were marked down in accordance with accounting guidance for PCI loans. See the Pick-a-Pay Portfolio section in this Report for additional detail.

The deterioration in specific segments of the Home Equity portfolio required a targeted approach to managing these assets. In fourth quarter 2007 a liquidating portfolio was identified, consisting of home equity loans generated through third party wholesale channels not behind a Wells Fargo first mortgage, and home equity loans acquired through correspondents. The liquidating portion of the Home Equity

portfolio was $8.9 billion at September 30, 2009, down from $9.3 billion at June 30, 2009. The loans in this liquidating portfolio represent about 1% of total loans outstanding at September 30, 2009, and contain some of the highest risk in our $124.2 billion Home Equity portfolio, with a loss rate of 12.17% compared with 3.69% 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 $115.3 billion at September 30, 2009, of which 97% was originated through the retail channel and approximately 16% of the outstanding balance was in a first lien position. The table below includes the credit attributes of these two portfolios. California loans represent the largest state concentration in each of these portfolios and have experienced among the highest early-term delinquency and loss rates.

HOME EQUITY PORTFOLIO (1)

	Outstanding balances		% of loans two payments or more past due		Annualized loss rate for quarter ended	
(in millions)	**Sept. 30, 2009**	Dec. 31, 2008	**Sept. 30, 2009**	Dec. 31, 2008	**Sept. 30, 2009**	Dec. 31, 2008 (2)
Core portfolio (3)						
California	**$ 30,841**	31,544	**3.97%**	2.95	**6.52**	3.94
Florida	**11,496**	11,781	**5.08**	3.36	**4.82**	4.39
New Jersey	**8,119**	7,888	**2.22**	1.41	**1.41**	0.78
Virginia	**5,736**	5,688	**1.60**	1.50	**1.22**	1.56
Pennsylvania	**4,971**	5,043	**1.95**	1.10	**1.51**	0.52
Other	**54,152**	56,415	**2.64**	1.97	**2.65**	1.59
Total	**115,315**	118,359	**3.13**	2.27	**3.69**	2.39
Liquidating portfolio						
California	**3,406**	4,008	**8.75**	6.69	**18.22**	12.32
Florida	**435**	513	**9.83**	8.41	**16.97**	13.60
Arizona	**206**	244	**8.25**	7.40	**22.33**	13.19
Texas	**161**	191	**1.68**	1.27	**2.15**	1.67
Minnesota	**112**	127	**3.39**	3.79	**8.52**	5.25
Other	**4,546**	5,226	**4.68**	3.28	**7.14**	4.73
Total	**8,866**	10,309	**6.51**	4.93	**12.17**	8.27
Total core and liquidating portfolios	**$ 124,181**	128,668	**3.37**	2.48	**4.31**	2.87

(1) Consists of real estate 1-4 family junior lien

mortgages and lines of credit secured by real estate from all groups, excluding PCI loans.

(2) Loss rates for 2008 for the core portfolio reflect results for Wachovia (not included in the Wells Fargo reported results) and Wells Fargo. For fourth quarter 2008, the Wells Fargo core portfolio on a stand-alone basis, outstanding balances and related annualized loss rates were $29,399 million (3.81%) for California, $2,677 million (6.87%) for Florida, $1,925 million (1.29%) for New Jersey, $1,827 million (1.26%) for Virginia, $1,073 million (1.17%) for Pennsylvania, $38,934 million (1.77%) for all other states, and $75,835 million (2.71%) in total.

(3) Includes equity lines of credit and closed-end second liens

associated with the Pick-a-Pay portfolio totaling $1.9 billion at September 30, 2009, and $2.1 billion at December 31, 2008.

Pick-a-Pay Portfolio

Our Pick-a-Pay portfolio, which we acquired in the Wachovia merger, had an unpaid principal balance of $107.3 billion and a carrying value of $87.8 billion at September 30, 2009. This portfolio includes loans that offer payment options (Pick-a-Pay option payment loans), loans that were originated without the option payment feature and loans that no longer offer the option feature as a result of our modification efforts since the acquisition. At September 30, 2009 the Pick-a-Pay option payment loans totaled $79.2 billion or 74% of the total portfolio, which is down from $101.3 billion or 86% at December 31, 2008. PCI loans in the Pick-a-Pay portfolio had an unpaid principal balance of $57.3 billion and a carrying value of $38.0 billion at September 30, 2009. A significant portion of the Pick-a-Pay PCI loans are option payment loans. The carrying value of the PCI loans is net of purchase accounting net write-downs to reflect their fair value at acquisition. Equity lines of credit and closed-end second liens associated with Pick-a-Pay loans are reported in the home equity portfolio. The Pick-a-Pay portfolio is a liquidating portfolio as Wachovia ceased originating new Pick-a-Pay loans in 2008. This portfolio declined $2.6 billion from June 30, 2009. We recorded a $22.4 billion write-down in purchase accounting on Pick-a-Pay loans that were impaired using the accounting guidance for PCI loans. Losses to date on this portfolio are reasonably in line with management s original expectations and our most recent life-of-loan loss projections show an improvement driven in part by extensive and currently successful modification efforts.

Pick-a-Pay option payment loans may be adjustable or fixed rate. They are home mortgages on which the customer has the option each month to select from among four payment options: (1) a minimum payment as described below, (2) an interest-only payment, (3) a fully amortizing 15-year payment, or (4) a fully amortizing 30-year payment.

The minimum monthly payment for substantially all of our Pick-a-Pay option payment loans is reset annually. The new minimum monthly payment amount usually cannot increase by more than 7.5% of the then-existing principal and interest payment amount. The minimum payment may not be sufficient to pay the monthly interest due and in those situations a loan on which the customer has made a minimum payment is subject to negative amortization, where unpaid interest is added to the principal balance of the loan. The amount of interest that has been added to a loan balance is referred to as deferred interest. Total deferred interest of $3.9 billion at September 30, 2009, was down from $4.2 billion at June 30, 2009, due to loan modification efforts as well as falling interest rates resulting in the minimum payment option covering the interest and some principal on many loans.

Deferral of interest on a Pick-a-Pay option payment loan may continue as long as the loan balance remains below a pre-defined principal cap, which is based on the percentage that the current loan balance represents to the original loan balance. Loans with an original loan-to-value (LTV) ratio equal to or below 85% have a cap of 125% of the original loan balance, and these loans represent substantially all the Pick-a-Pay portfolio. Loans with an original LTV ratio above 85% have a cap of 110% of the original loan balance. Most of the Pick-a-Pay loans on which there is a deferred interest balance re-amortize (the monthly payment amount is reset or recast) on the earlier of the date when the loan balance reaches its principal cap, or the 10-year anniversary of the loan. There exists a small population of Pick-a-Pay loans for which recast occurs at the five-year anniversary. After a recast, the customers new payment terms are reset to the amount necessary to repay the balance over the remainder of the original loan term.

Due to the terms of the Pick-a-Pay option payment loans, we believe there is little recast risk over the next three years. Based on assumptions of a flat rate environment, if all eligible customers elect the minimum payment option 100% of the time and no balances prepay, we would expect the following balance of loans to recast based on reaching the principal cap: $1 million in the remaining quarter of 2009, $3 million in 2010, $1 million in 2011 and $6 million in 2012. In third quarter 2009, the amount of

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loans recast based on reaching the principal cap was minimal. In addition, we would expect the following balances of ARM loans to start fully amortizing due to reaching their recast anniversary date and also having a payment change at the recast date greater than the annual 7.5% reset: $2 million in the remaining quarter of 2009, $39 million in 2010, $44 million in 2011 and $72 million in 2012. In third quarter 2009, the amount of loans reaching their recast anniversary date and also having a payment change over the annual 7.5% reset was $9 million.

The table below reflects the geographic distribution of the Pick-a-Pay portfolio broken out between PCI loans and all other loans. In stressed housing markets with declining home prices and increasing delinquencies, the LTV ratio is one important metric in predicting future loan performance, including potential charge-offs. Because PCI loans are carried at fair value, the ratio of the carrying value to the current collateral value for acquired loans with credit impairment will be lower as compared to the LTV based on the unpaid principal. For informational purposes, we have included both ratios in the following table.

PICK-A-PAY PORTFOLIO

							September 30, 2009
				PCI loans			All other loans
(in millions)	Unpaid principal balance	Current LTV ratio (1)	Carrying value (2)	Ratio of carrying value to current value	Unpaid principal balance	Current LTV ratio (1)	Carrying value (2)
California	$ 39,034	150%	$ 25,492	98%	$ 24,447	95%	$ 24,395
Florida	5,929	144	3,532	85	5,166	108	5,117
New Jersey	1,676	101	1,309	78	3,017	82	3,021
Texas	452	81	395	71	2,031	66	2,039
Arizona	1,481	155	742	78	1,160	105	1,152
Other states	8,738	110	6,520	82	14,128	85	14,120
Total Pick-a-Pay loans	$ 57,310		$ 37,990		$ 49,949		$ 49,844

(1) The current LTV ratio is calculated as the unpaid principal balance plus the unpaid principal balance of any equity lines of credit that share common collateral divided by the collateral value.

Collateral values are generally determined using automated valuation models (AVM) and are updated quarterly. AVMs are computer-based tools used to estimate market values of homes based on processing large volumes of market data including market comparables and price trends for local market areas.

(2) Carrying value, which does not reflect the allowance for loan losses, includes purchase accounting adjustments, which, for PCI loans are the nonaccretable difference and the accretable yield, and for all other loans, an adjustment to mark the loans to a market yield at date of merger less any subsequent charge-offs.

To maximize return and allow flexibility for customers to avoid foreclosure, we have in place several loss mitigation strategies for our Pick-a-Pay loan portfolio. We contact customers who are experiencing difficulty and may in certain cases modify the terms of a loan based on a customer s documented income and other circumstances. We also are actively modifying the Pick-a-Pay portfolio. Because of the write-down of the PCI group of loans in purchase accounting, our post merger modifications to PCI Pick-a-Pay loans have not resulted in any modification-related provision for credit losses.

We also have taken steps to work with customers to refinance or restructure their Pick-a-Pay loans into other loan products. For customers at risk, we offer combinations of term extensions of up to 40 years (from 30 years), interest rate reductions, to charge no interest on a portion of the principal for some period of time and, in geographies with substantial property value declines, we will even offer permanent principal reductions. In third quarter 2009, we completed 19,148 full-term loan modifications, up from 18,465 in second quarter 2009. The majority of the loan modifications are concentrated in our impaired loan portfolio. As part of the modification process, the loans are re-underwritten, income is documented and the negative amortization feature is eliminated. Most of the modifications result in material payment reduction to the customer. We continually reassess our loss mitigation strategies and may adopt

additional or different strategies in the future. We believe a key factor to successful loss mitigation is tailoring the revised loan payment to the customer s sustainable income.

Credit Cards

Our credit card portfolio, a portion of which is included in the Wells Fargo Financial discussion below, totaled $23.6 billion at September 30, 2009, which is less than 3% of our total outstanding loans and is smaller than that of many of our large peer banks. Delinquencies at September 30, 2009, of 30 days or more were 6.22% of credit card outstandings, up slightly from 6.02% for the prior quarter. Net charge-offs were 10.97% (annualized) for third quarter 2009, down from 11.52% (annualized) in second quarter 2009, reflecting high bankruptcy filings and the current economic environment. We have tightened underwriting criteria and imposed credit line management changes to minimize balance transfers and line increases.

Wells Fargo Financial

Wells Fargo Financial originates real estate loans, substantially all of which are secured debt consolidation loans, and both prime and non-prime auto secured loans, unsecured loans and credit cards.

Wells Fargo Financial had total real estate secured loans of $27.0 billion at September 30, 2009, and $29.1 billion at December 31, 2008. Of this portfolio, $1.7 billion and $1.8 billion, respectively, was considered prime based on secondary market standards and has been priced to the customer accordingly. The remaining portfolio is non-prime but has been originated with standards to reduce credit risk. These loans were originated through our retail channel with documented income, LTV limits based on credit quality and property characteristics, and risk-based pricing. In addition, the loans were originated without teaser rates, interest-only or negative amortization features. Credit losses in the portfolio have increased in the current economic environment compared with historical levels, but remained below industry averages for non-prime mortgage portfolios, with overall loss rates in the first nine months of 2009 of 2.94% on the entire portfolio. Of the portfolio, $8.8 billion at September 30, 2009, was originated with customer FICO scores below 620, but these loans have further restrictions on LTV and debt-to-income ratios to limit the credit risk.

Wells Fargo Financial also had auto secured loans and leases of $18.1 billion at September 30, 2009, and $23.6 billion at December 31, 2008, of which $4.9 billion and $6.3 billion, respectively, was originated with customer FICO scores below 620. Loss rates in this portfolio in the third quarter and first nine months of 2009 were 5.19% and 5.04%, respectively, for FICO scores of 620 and above, and 7.07% and 6.79%, respectively, for FICO scores below 620. These loans were priced based on relative risk. Of this portfolio, $12.9 billion represented loans and leases originated through its indirect auto business, a channel Wells Fargo Financial ceased using near the end of 2008.

Wells Fargo Financial had unsecured loans and credit card receivables of $8.0 billion at September 30, 2009, and $8.4 billion at December 31, 2008, of which $1.1 billion and $1.3 billion, respectively, was originated with customer FICO scores below 620. Net loss rates in this portfolio in the third quarter and first nine months of 2009 were 13.01% and 13.50%, respectively, for FICO scores of 620 and above, and 17.49% and 19.59%, respectively, for FICO scores below 620. Wells Fargo Financial has been actively tightening credit policies and managing credit lines to reduce exposure given current economic conditions.

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Nonaccrual Loans and Other Nonperforming Assets

The following table shows the comparative data for nonaccrual loans and other nonperforming assets. We generally place loans on nonaccrual status when:

- the full and timely collection of interest or principal becomes uncertain;
- they are 90 days (120 days with respect to real estate 1-4 family first and junior lien mortgages and auto loans) past due for interest or principal (unless both well-secured and in the process of collection); or
- part of the principal balance has been charged off and no restructuring has occurred.

Note 1 (Summary of Significant Accounting Policies) to Financial Statements in our 2008 Form 10-K describes our accounting policy for nonaccrual loans.

NONACCRUAL LOANS AND OTHER NONPERFORMING ASSETS (1)

Total nonperforming assets were $23.5 billion (2.93% of total loans) at September 30, 2009, and included $20.9 billion of nonaccrual loans and $2.6 billion of foreclosed assets, real estate and other nonaccrual investments.

(in millions)	**Sept. 30, 2009**	June 30, 2009	Dec. 31, 2008
Nonaccrual loans:			
Commercial and commercial real estate:			
Commercial	**$ 4,540**	2,910	1,253
Real estate mortgage	**2,856**	2,343	594
Real estate construction	**2,711**	2,210	989
Lease financing	**157**	130	92
Total commercial and commercial real estate	**10,264**	7,593	2,928
Consumer:			
Real estate 1-4 family first mortgage	**8,132**	6,000	2,648
Real estate 1-4 family junior lien mortgage	**1,985**	1,652	894
Other revolving credit and installment	**344**	327	273
Total consumer	**10,461**	7,979	3,815
Foreign	**144**	226	57
Total nonaccrual loans (1) (2) (3)	**20,869**	15,798	6,800
As a percentage of total loans	**2.61%**	1.92	0.79
Foreclosed assets:			
GNMA loans (4)	**840**	932	667
Other	**1,687**	1,592	1,526
Real estate and other nonaccrual investments (5)	**55**	20	16
Total nonaccrual loans and other nonperforming assets	**$ 23,451**	18,342	9,009
As a percentage of total loans	**2.93%**	2.23	1.04

(1) Includes nonaccrual mortgages held for sale and loans held for sale in their respective loan categories.
(2) Excludes loans acquired from Wachovia that are accounted for as PCI loans.
(3) Includes $9.0 billion and $3.6 billion at September 30, 2009, and December 31, 2008, respectively, of loans classified as impaired under FASB ASC 310 (FAS 114, *Accounting by Creditors for Impairment of a Loan, an Amendment of FASB Statements No. 5 and 15*) where the scope of this pronouncement encompasses nonaccrual commercial loans greater than $5 million and all consumer TDRs that are nonaccrual. See Note 5 to Financial Statements in this Report and Note 6 (Loans and Allowance for Credit Losses) to

Financial Statements in our 2008 Form 10-K for further information on impaired loans.

(4) Consistent with regulatory reporting requirements, foreclosed real estate securing Government National Mortgage Association (GNMA) loans is classified as nonperforming. Both principal and interest for GNMA loans secured by the foreclosed real estate are collectible because the GNMA loans are insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA).

(5) Includes real estate investments (contingent interest loans accounted for as investments) that would be classified as nonaccrual if these assets were recorded as loans, and nonaccrual debt securities.

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Nonaccrual loans increased $5.1 billion from June 30, 2009. The increase in nonaccrual loans was primarily attributable to deterioration in certain portfolios, particularly commercial loans and consumer real estate. Also, the rate of nonaccrual growth has been somewhat increased by the effect of accounting for substantially all of Wachovia s nonaccrual loans as PCI loans at year-end 2008. This purchase accounting resulted in reclassifying all but $97 million of Wachovia nonaccruing loans to accruing status, resulting in a reduced level of nonaccrual loans as of our merger date, and limiting comparability of this metric and related credit ratios with our peers. Typically, changes to nonaccrual loans period-over-period represent inflows for loans that reach a specified past due status, offset by reductions for loans that are charged off, sold, transferred to foreclosed properties, or are no longer classified as nonaccrual because they return to accrual status. The impact of purchase accounting on our credit data should diminish over time. In addition, we have also increased loan modifications and restructurings to assist homeowners and other borrowers in the current difficult economic cycle. This increase is expected to result in elevated nonaccrual loan levels for longer periods because consumer nonaccrual loans that have been modified remain in nonaccrual status until a borrower has made six consecutive contractual payments, inclusive of consecutive payments made prior to the modification. For a consumer accruing loan that has been modified, if the borrower has demonstrated performance under the previous terms and shows the capacity to continue to perform under the restructured terms, the loan will remain in accruing status. Otherwise, the loan will be placed in a nonaccrual status until the borrower has made six consecutive contractual payments.

As explained in more detail below, we believe the loss exposure expected in our nonperforming assets is mitigated by three factors. First, 96% of our nonaccrual loans are secured. Second, losses have already been recognized on 37% of total nonaccrual loans. Third, there is a segment of nonaccrual loans for which there are specific reserves in the allowance, while others are covered by general reserves. We are seeing signs of stability in our credit portfolio, as growth in credit losses slowed during third quarter 2009. We expect credit losses to remain elevated in the near term, but, assuming no further economic deterioration; we expect credit losses to peak in the first half of 2010 in our consumer portfolios and later in 2010 in our commercial and commercial real estate portfolios.

Commercial and commercial real estate nonaccrual loans amounted to $10.3 billion at September 30, 2009, compared with $7.6 billion at June 30, 2009, $4.5 billion at March 31, 2009, and $2.9 billion at December 31, 2008. Of the approximately $10.3 billion total commercial and commercial real estate nonaccrual loans at September 30, 2009:

- $7.3 billion, have had $1.3 billion of loan impairments recorded for expected life-of-loan losses in accordance with impairment accounting standards;
- the remaining $3.0 billion have reserves as part of the allowance for loan losses;
- $9.5 billion (92%) are secured, of which $5.5 billion (53%) are secured by real estate, and the remainder secured by other assets such as receivables, inventory and equipment;
- over one-third of these nonaccrual loans are paying interest that is being applied to principal; and
- 23% have been written down by approximately 40%.

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Consumer nonaccrual loans amounted to $10.5 billion at September 30, 2009, compared with $8.0 billion at June 30, 2009, $5.9 billion at March 31, 2009, and $3.8 billion at December 31, 2008. The $6.6 billion increase in nonaccrual consumer loans from December 31, 2008, represented an increase of $5.5 billion in 1-4 family first mortgage loans (including a $3.7 billion increase from Wachovia) and an increase of $1.1 billion in 1-4 family junior liens (including a $402 million increase from Wachovia). Of the $10.5 billion of consumer nonaccrual loans:

- $1.8 billion of TDRs have had $288 million in life-of-loan loss impairment reserves;
- the remaining $8.7 billion have reserves as part of the allowance for loan losses;
- $10.5 billion (99%) are secured, substantially all by real estate;
- 24% have a combined loan to value of 80% or below; and
- $5.2 billion have had charge-offs totaling $1.5 billion; consumer loans secured by real estate are charged-off to the appraised value, less costs to sell, of the underlying collateral when these loans reach 180 days delinquent.

The following table summarizes nonperforming assets for the last three quarters for legacy Wells Fargo and Wachovia portfolios. As explained above, the third quarter 2009 growth in the Wachovia nonaccruals was influenced by the anomalies created in purchase accounting of reclassifying substantially all Wachovia nonaccrual loans to accruing status as of year-end 2008.

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NONACCRUAL LOANS AND OTHER NONPERFORMING ASSETS BY LEGACY WELLS FARGO AND WACHOVIA

	Sept. 30, 2009		June 30, 2009		March 31, 2009	
(in millions)	**Balances**	**As a % of total loans**	Balances	As a % of total loans	Balances	As a % of total loans
Commercial and commercial real estate:						
Legacy Wells Fargo	**$ 6,037**	**3.53%**	$ 5,260	3.02%	$ 3,860	2.13%
Wachovia	**4,227**	**2.86**	2,333	1.46	645	0.39
Total commercial and commercial real estate	**10,264**	**3.22**	7,593	2.28	4,505	1.30
Consumer:						
Legacy Wells Fargo	**6,293**	**2.90**	5,687	2.59	4,970	2.22
Wachovia	**4,168**	**1.78**	2,292	0.96	966	0.40
Total consumer	**10,461**	**2.32**	7,979	1.74	5,936	1.27
Foreign	**144**	**0.48**	226	0.75	75	0.24
Total nonaccrual loans	**20,869**	**2.61**	15,798	1.92	10,516	1.25
Foreclosed assets:						
Legacy Wells Fargo	**1,756**		1,741		1,421	
Wachovia	**771**		783		641	
Total foreclosed assets	**2,527**		2,524		2,062	
Real estate and other nonaccrual investments	**55**		20		34	
Total nonaccrual loans and other nonperforming assets	**$ 23,451**	**2.93%**	$ 18,342	2.23%	$ 12,612	1.50%
Change from prior quarter	**$ 5,109**		$ 5,730		$ 3,603	

While commercial and commercial real estate nonaccrual loans were up in third quarter 2009, the dollar amount of the increase declined in third quarter 2009 and the rate of growth slowed considerably. Legacy Wells Fargo s commercial and commercial real estate nonaccrual loans increased $777 million, or 15%, from second quarter 2009, compared with $1.4 billion, or 36%, in second quarter 2009 from first quarter 2009. Legacy Wachovia commercial and commercial real estate nonaccrual loans increased $1.9 billion, or 81%, from second quarter 2009, compared with

$1.7 billion, or 262%, in second quarter 2009 from first quarter 2009. Similarly, the growth rate in consumer nonaccrual loans also slowed in third quarter 2009. Legacy Wells Fargo s consumer nonaccrual loans increased $606 million, or 11%, from second quarter 2009, compared with $717 million, or 14%, in second quarter 2009 from first quarter 2009. Legacy Wachovia s consumer nonaccrual loans increased $1.9 billion, or 82%, from second quarter 2009, compared with $1.3 billion, or 137%, in second quarter 2009 from first quarter 2009. Wachovia s Pick-a-Pay portfolio represents the largest portion of consumer nonaccrual loans and were up $1.2 billion in third quarter 2009 from second quarter 2009.

Total consumer TDRs amounted to $7.2 billion at September 30, 2009, compared with $5.6 billion at June 30, 2009. Of the TDRs, $1.8 billion at September 30, 2009, and $1.2 billion at June 30, 2009, were classified as nonaccrual. We strive to identify troubled loans and work with the customer to modify to more affordable terms before their loan reaches nonaccrual status. We establish an impairment reserve when a loan is restructured in a TDR.

We expect nonperforming asset balances to continue to grow, reflecting some continued deterioration in credit, as well as our efforts to modify more real estate loans to reduce foreclosures and keep customers in their homes. We remain focused on proactively identifying problem credits, moving them to nonperforming status and recording the loss content in a timely manner. We have increased and will continue to increase staffing in our workout and collection organizations to ensure these troubled borrowers receive the attention and help they need. See the Allowance for Credit Losses section in this

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Report for additional discussion. The performance of any one loan can be affected by external factors, such as economic or market conditions, or factors affecting a particular borrower.

Loans 90 Days or More Past Due and Still Accruing

Loans included in this category are 90 days or more past due as to interest or principal and still accruing, because they are (1) well-secured and in the process of collection or (2) real estate 1-4 family first mortgage loans or consumer loans exempt under regulatory rules from being classified as nonaccrual. PCI loans are excluded from the disclosure of loans 90 days or more past due and still accruing interest. Even though certain PCI loans are 90 days or more contractually past due, they are considered to be accruing because the interest income on these loans relates to the establishment of an accretable yield in purchase accounting and not to contractual interest payments.

The total of loans 90 days or more past due and still accruing was $18,911 million at September 30, 2009, and $11,830 million at December 31, 2008. The total included $12,897 million and $8,184 million for the same dates, respectively, in advances pursuant to our servicing agreements to GNMA mortgage pools and similar loans whose repayments are insured by the FHA or guaranteed by the VA.

The following table reflects loans 90 days or more past due and still accruing excluding the insured/guaranteed GNMA advances.

LOANS 90 DAYS OR MORE PAST DUE AND STILL ACCRUING
(EXCLUDING INSURED/GUARANTEED GNMA AND SIMILAR LOANS)

(in millions)	**Sept. 30, 2009**	Dec. 31, 2008(1)
Commercial and commercial real estate:		
Commercial	**$ 458**	218
Real estate mortgage	**693**	88
Real estate construction	**930**	232
Total commercial and commercial real estate	**2,081**	538
Consumer:		
Real estate 1-4 family first mortgage (2)	**1,552**	883
Real estate 1-4 family junior lien mortgage	**484**	457
Credit card	**683**	687
Other revolving credit and installment	**1,138**	1,047
Total consumer	**3,857**	3,074
Foreign	**76**	34
Total	**$ 6,014**	3,646

(1) The amount of real estate 1-4 family first and junior lien mortgage loan delinquencies as

originally reported at December 31, 2008, included certain PCI loans previously classified as nonaccrual by Wachovia. The December 31, 2008, amounts have been revised to exclude those loans.

(2) Includes mortgage loans held for sale 90 days or more past due and still accruing.

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Net Charge-offs

NET CHARGE-OFFS BY LEGACY WELLS FARGO AND WACHOVIA

					Quarter ended	
	Sept. 30, 2009		June 30, 2009		March 31, 2009	
(in millions)	**Net loan charge-offs**	**As a % of average loans(1)**	Net loan charge-offs	As a % of average loans(1)	Net loan charge-offs	As a % of average loans(1)
Commercial and commercial real estate:						
Legacy Wells Fargo	**$ 862**	**1.96%**	$ 897	2.01%	$ 667	1.48%
Wachovia	**602**	**1.57**	246	0.61	30	0.07
Total commercial and commercial real estate	**1,464**	**1.78**	1,143	1.35	697	0.80
Consumer:						
Legacy Wells Fargo	**2,480**	**4.50**	2,462	4.44	2,175	3.90
Wachovia	**1,107**	**1.87**	735	1.22	341	0.56
Total consumer	**3,587**	**3.13**	3,197	2.77	2,516	2.16
Foreign:						
Legacy Wells Fargo	**43**	**3.00**	43	3.05	45	3.13
Wachovia	**17**	**0.28**	3	0.05		
Total foreign	**60**	**0.79**	46	0.61	45	0.56
Total Legacy Wells Fargo	**3,385**	**3.37**	3,402	3.35	2,887	2.82
Total Wachovia	**1,726**	**1.66**	984	0.92	371	0.34
Total net charge-offs	**$ 5,111**	**2.50%**	$ 4,386	2.11%	$ 3,258	1.54%

(1) Annualized.

Net charge-offs in third quarter 2009 were $5.1 billion (2.50% of average total loans outstanding, annualized), including $1.7 billion in the Wachovia portfolio, compared with $4.4 billion (2.11%) in second quarter 2009. The increases in net charge-offs this quarter were predominantly from the Wachovia portfolios. The increase in commercial and commercial real estate losses was entirely in the Wachovia portfolio, in part reflecting the fact that charge-offs are just now coming through Wachovia s portfolio after having eliminated nonaccruals through purchase accounting at the end of 2008. The overall loss rate in third quarter for Wachovia s non-PCI commercial and commercial real estate portfolio was similar to Wells Fargo s commercial portfolio, which we believe was underwritten to conservative credit standards. Over 40% of the increase in Wachovia consumer loan losses came from

the non-PCI Pick-a-Pay portfolio, in large part reflecting the lagging effect of purchase accounting.

Allowance for Credit Losses

The allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, is management s estimate of credit losses inherent in the loan portfolio at the balance sheet date and excludes loans carried at fair value. The process for determining the adequacy of the allowance for credit losses is critical to our financial results. It requires difficult, subjective and complex judgments, as a result of the need to make estimates about the effect of matters that are uncertain. See the Financial Review Critical Accounting Policies Allowance for Credit Losses section in our 2008 Form 10-K for additional information.

We apply a consistent methodology to determine the allowance for credit losses, using both historical and forecasted loss trends, adjusted for underlying economic and market conditions. Our allowance evaluation methodology generally involves individual evaluation for large credits and the application of statistical evaluation for individually smaller credits. For individually graded (typically commercial) portfolios, we generally use loan-level credit quality ratings, which are based on borrower information

and strength of collateral, combined with historically-based grade specific loss factors. The allowance for individually-rated nonaccruing commercial loans with an outstanding balance of $5 million or greater is determined through an individual impairment analysis consistent with accounting guidance for loan impairment. For statistically evaluated portfolios (typically consumer), we generally leverage models which use credit-related characteristics such as credit rating scores, delinquency migration rates, vintages, and portfolio concentrations to estimate loss content. Additionally, the allowance for consumer TDRs is based on the risk characteristics of the modified loans and the resultant estimated cash flows discounted at the pre-modification yield of the loan. While the allowance is determined using product and business segment estimates, it is available to absorb losses in the entire loan portfolio.

At September 30, 2009, the allowance for credit losses totaled $24.5 billion (3.07% of total loans), compared with $21.7 billion (2.51%) at December 31, 2008. The allowance for loan losses was $24.0 billion (3.00%) at September 30, 2009, compared with $21.0 billion (2.43%) at December 31, 2008. The allowance for credit losses at September 30, 2009, included $233 million related to PCI loans acquired from Wachovia. The reserve for unfunded credit commitments was $500 million at September 30, 2009, compared with $698 million at December 31, 2008.

Total provision expense in the third quarter and first nine months of 2009 was $6.1 billion and $15.8 billion, respectively, and included a net build to the allowance for credit losses of $1.0 billion and $3.0 billion, respectively. About $900 million of the allowance build was for our commercial portfolios with $400 million for continued deterioration in commercial loans, $300 million for expected life-of-loan losses on impaired commercial loans and nearly $200 million for additional impairment on PCI commercial loans. The consumer portfolio added approximately $100 million of allowance build with $400 million added for loan modifications offset by $345 million for release of allowance on performing loans. Based on our current expectation that consumer related losses will peak in the first half of 2010 and then begin to gradually decline, the allowance build for consumer loan losses has decreased when compared to the allowance build at June 30, 2009.

The accounting for loans acquired from Wachovia with credit impairment affects reported net charge-offs and nonaccrual loans as described on page 5 in this Report. Therefore, the allowance ratios associated with these measures should not be considered when evaluating the adequacy of the allowance or for comparison with other peer banks because the information may not be directly comparable.

The ratio of the allowance for credit losses to total nonaccrual loans was 118% at September 30, 2009, and 319% at December 31, 2008, and the ratio of the allowance for credit losses to annualized net charge-offs was 121% and 134% for the quarters ended September 30, 2009, and June 30, 2009, respectively. The decrease in the allowance ratio from December 31, 2008, and June 30, 2009, continued to be primarily related to the increase in Wachovia nonaccrual loans emerging from the portfolio of those loans that were not designated as PCI loans at the acquisition date.

We believe the allowance for credit losses of $24.5 billion was adequate to cover credit losses inherent in the loan portfolio, including unfunded credit commitments, at September 30, 2009. The allowance for credit losses is subject to change and considers existing factors at the time, including economic or market conditions and ongoing internal and external examination processes. Due to the sensitivity of the allowance for credit losses to changes in the economic environment, it is possible that unanticipated economic deterioration would create incremental credit losses not anticipated as of the balance sheet date. Our process for determining the adequacy of the allowance for credit losses is discussed in the Financial Review Critical Accounting Policies Allowance for Credit Losses section and Note 6 (Loans and Allowance for Credit Losses) to Financial Statements in our 2008 Form 10-K.

ASSET/LIABILITY AND MARKET RISK MANAGEMENT

Asset/liability management involves the evaluation, monitoring and management of interest rate risk, market risk, liquidity and funding. The Corporate Asset/Liability Management Committee (Corporate ALCO) which oversees these risks and reports periodically to the Finance Committee of the Board consists of senior financial and business executives. Each of our principal business groups has individual asset/liability management committees and processes linked to the Corporate ALCO process.

Interest Rate Risk

Interest rate risk, which potentially can have a significant earnings impact, is an integral part of being a financial intermediary. We are subject to interest rate risk because:

- assets and liabilities may mature or reprice at different times (for example, if assets reprice faster than liabilities and interest rates are generally falling, earnings will initially decline);
- assets and liabilities may reprice at the same time but by different amounts (for example, when the general level of interest rates is falling, we may reduce rates paid on checking and savings deposit accounts by an amount that is less than the general decline in market interest rates);
- short-term and long-term market interest rates may change by different amounts (for example, the shape of the yield curve may affect new loan yields and funding costs differently); or
- the remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change (for example, if long-term mortgage interest rates decline sharply, mortgage-backed securities held in the securities available-for-sale portfolio may prepay significantly earlier than anticipated which could reduce portfolio income).

Interest rates may also have a direct or indirect effect on loan demand, credit losses, mortgage origination volume, the fair value of MSRs and other financial instruments, the value of the pension liability and other items affecting earnings.

We assess interest rate risk by comparing our most likely earnings plan with various earnings simulations using many interest rate scenarios that differ in the direction of interest rate changes, the degree of change over time, the speed of change and the projected shape of the yield curve. For example, as of September 30, 2009, our most recent simulation indicated estimated earnings at risk of approximately 5% of our most likely earnings plan using a scenario in which the federal funds rate rises to 3.75% and the 10-year Constant Maturity Treasury bond yield rises to 5.90% by September 2010. Simulation estimates depend on, and will change with, the size and mix of our actual and projected balance sheet at the time of each simulation. Due to timing differences between the quarterly valuation of MSRs and the eventual impact of interest rates on mortgage banking volumes, earnings at risk in any particular quarter could be higher than the average earnings at risk over the 12-month simulation period, depending on the path of interest rates and on our hedging strategies for MSRs. See the Mortgage Banking Interest Rate and Market Risk section in this Report.

We use exchange-traded and over-the-counter interest rate derivatives to hedge our interest rate exposures. The notional or contractual amount and fair values of these derivatives are presented in Note 11 (Derivatives) to Financial Statements in this Report. We use derivatives for asset/liability management in three main ways:

- to convert a major portion of our long-term fixed-rate debt, which we issue to finance the Company, from fixed-rate payments to floating-rate payments by entering into receive-fixed swaps;
- to convert the cash flows from selected asset and/or liability instruments/portfolios from fixed-rate payments to floating-rate payments or vice versa; and
- to hedge our mortgage origination pipeline, funded mortgage loans, MSRs and other interests held using interest rate swaps, swaptions, futures, forwards and options.

Mortgage Banking Interest Rate and Market Risk

We originate, fund and service mortgage loans, which subjects us to various risks, including credit, liquidity and interest rate risks. Based on market conditions and other factors, we reduce credit and liquidity risks by selling or securitizing some or all of the long-term fixed-rate mortgage loans we originate and most of the ARMs we originate. On the other hand, we may hold originated ARMs and fixed-rate mortgage loans in our loan portfolio as an investment for our growing base of core deposits. We determine whether the loans will be held for investment or held for sale at the time of commitment. We may subsequently change our intent to hold loans for investment and sell some or all of our ARMs or fixed-rate mortgages as part of our corporate asset/liability management. We may also acquire and add to our securities available for sale a portion of the securities issued at the time we securitize MHFS.

Notwithstanding the continued downturn in the housing sector, and the continued lack of liquidity in the nonconforming secondary markets, our mortgage banking revenue growth continued to be positive, reflecting the complementary origination and servicing strengths of the business. The secondary market for agency-conforming mortgages functioned well during the quarter.

Interest rate and market risk can be substantial in the mortgage business. Changes in interest rates may potentially impact total origination and servicing fees, the value of our residential MSRs measured at fair value, the value of MHFS and the associated income and loss reflected in mortgage banking noninterest income, the income and expense associated with instruments (economic hedges) used to hedge changes in the fair value of MSRs and MHFS, and the value of derivative loan commitments (interest rate locks) extended to mortgage applicants.

Interest rates impact the amount and timing of origination and servicing fees because consumer demand for new mortgages and the level of refinancing activity are sensitive to changes in mortgage interest rates. Typically, a decline in mortgage interest rates will lead to an increase in mortgage originations and fees and may also lead to an increase in servicing fee income, depending on the level of new loans added to the servicing portfolio and prepayments. Given the time it takes for consumer behavior to fully react to interest rate changes, as well as the time required for processing a new application, providing the commitment, and securitizing and selling the loan, interest rate changes will impact origination and servicing fees with a lag. The amount and timing of the impact on origination and servicing fees will depend on the magnitude, speed and duration of the change in interest rates.

In accordance with the fair value option measurement provisions of the Codification, we elected to measure MHFS at fair value prospectively for new prime MHFS originations for which an active secondary market and readily available market prices existed to reliably support fair value pricing models used for these loans. At December 31, 2008, we elected to measure at fair value similar MHFS acquired from Wachovia. Loan origination fees on these loans are recorded when earned, and related direct loan origination costs and fees are recognized when incurred. We also elected to measure at fair value certain of our other interests held related to residential loan sales and securitizations. We believe that the election for new prime MHFS and other interests held, which are now hedged with free-standing derivatives (economic hedges) along with our MSRs, reduces certain timing differences and better matches changes in the value of these assets with changes in the value of derivatives used as economic hedges for these assets. During 2008 and the first nine months of 2009, in response to continued secondary market illiquidity, we continued to originate certain prime non-agency loans to be held for investment for the foreseeable future rather than to be held for sale.

Under the Transfers and Servicing topic of the Codification, we elected to use the fair value measurement method to initially measure and carry our residential MSRs, which represent substantially all of our MSRs. Under this method, the MSRs are recorded at fair value at the time we sell or securitize the related mortgage loans. The carrying value of MSRs reflects changes in fair value at the end of each quarter and

changes are included in net servicing income, a component of mortgage banking noninterest income. If the fair value of the MSRs increases, income is recognized; if the fair value of the MSRs decreases, a loss is recognized. We use a dynamic and sophisticated model to estimate the fair value of our MSRs and periodically benchmark our estimates to independent appraisals. The valuation of MSRs can be highly subjective and involve complex judgments by management about matters that are inherently unpredictable. Changes in interest rates influence a variety of significant assumptions included in the periodic valuation of MSRs, including prepayment speeds, expected returns and potential risks on the servicing asset portfolio, the value of escrow balances and other servicing valuation elements.

A decline in interest rates generally increases the propensity for refinancing, reduces the expected duration of the servicing portfolio and therefore reduces the estimated fair value of MSRs. This reduction in fair value causes a charge to income, net of any gains on free-standing derivatives (economic hedges) used to hedge MSRs. We may choose not to fully hedge all of the potential decline in the value of our MSRs resulting from a decline in interest rates because the potential increase in origination/servicing fees in that scenario provides a partial natural business hedge. An increase in interest rates generally reduces the propensity for refinancing, extends the expected duration of the servicing portfolio and therefore increases the estimated fair value of the MSRs. However, an increase in interest rates can also reduce mortgage loan demand and therefore reduce origination income. In third quarter 2009, a $2.1 billion decrease in the fair value of our MSRs and $3.6 billion of gains on free-standing derivatives used to hedge the MSRs resulted in a net gain of $1.5 billion. This net gain was largely due to hedge-carry income reflecting the current low short-term interest rate environment. The low short-term interest rate environment is likely to continue into fourth quarter 2009.

Hedging the various sources of interest rate risk in mortgage banking is a complex process that requires sophisticated modeling and constant monitoring. While we attempt to balance these various aspects of the mortgage business, there are several potential risks to earnings:

- MSRs valuation changes associated with interest rate changes are recorded in earnings immediately within the accounting period in which those interest rate changes occur, whereas the impact of those same changes in interest rates on origination and servicing fees occur with a lag and over time. Thus, the mortgage business could be protected from adverse changes in interest rates over a period of time on a cumulative basis but still display large variations in income from one accounting period to the next.
- The degree to which the natural business hedge offsets changes in MSRs valuations is imperfect, varies at different points in the interest rate cycle, and depends not just on the direction of interest rates but on the pattern of quarterly interest rate changes.
- Origination volumes, the valuation of MSRs and hedging results and associated costs are also impacted by many factors. Such factors include the mix of new business between ARMs and fixed-rated mortgages, the relationship between short-term and long-term interest rates, the degree of volatility in interest rates, the relationship between mortgage interest rates and other interest rate markets, and other interest rate factors. Many of these factors are hard to predict and we may not be able to directly or perfectly hedge their effect.
- While our hedging activities are designed to balance our mortgage banking interest rate risks, the financial instruments we use may not perfectly correlate with the values and income being hedged. For example, the change in the value of ARMs production held for sale from changes in mortgage interest rates may or may not be fully offset by Treasury and LIBOR index-based financial instruments used as economic hedges for such ARMs. Additionally, the hedge-carry income we earn on our economic hedges for the MSRs may not continue if the spread between short-term and long-term rates decreases.

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The total carrying value of our residential and commercial MSRs was $15.7 billion at September 30, 2009, and $16.2 billion at December 31, 2008. The weighted-average note rate on the owned servicing portfolio was 5.72% at September 30, 2009, and 5.92% at December 31, 2008. Our total MSRs were 0.83% of mortgage loans serviced for others at September 30, 2009, compared with 0.87% at December 31, 2008.

As part of our mortgage banking activities, we enter into commitments to fund residential mortgage loans at specified times in the future. A mortgage loan commitment is an interest rate lock that binds us to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock. These loan commitments are derivative loan commitments if the loans that will result from the exercise of the commitments will be held for sale. These derivative loan commitments are recognized at fair value in the balance sheet with changes in their fair values recorded as part of mortgage banking noninterest income. We were required by Staff Accounting Bulletin No. 109, *Written Loan Commitments Recorded at Fair Value Through Earnings*, to include at inception and during the life of the loan commitment, the expected net future cash flows related to the associated servicing of the loan as part of the fair value measurement of derivative loan commitments. Changes subsequent to inception are based on changes in fair value of the underlying loan resulting from the exercise of the commitment and changes in the probability that the loan will not fund within the terms of the commitment, referred to as a fall-out factor. The value of the underlying loan commitment is affected primarily by changes in interest rates and the passage of time.

Outstanding derivative loan commitments expose us to the risk that the price of the mortgage loans underlying the commitments might decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. To minimize this risk, we utilize forwards and options, Eurodollar futures and options, and Treasury futures, forwards and option contracts as economic hedges against the potential decreases in the values of the loans. We expect that these derivative financial instruments will experience changes in fair value that will either fully or partially offset the changes in fair value of the derivative loan commitments. However, changes in investor demand, such as concerns about credit risk, can also cause changes in the spread relationships between underlying loan value and the derivative financial instruments that cannot be hedged.

Market Risk Trading Activities

From a market risk perspective, our net income is exposed to changes in interest rates, credit spreads, foreign exchange rates, equity and commodity prices and their implied volatilities. The primary purpose of our trading businesses is to accommodate customers in the management of their market price risks. Also, we take positions based on market expectations or to benefit from price differences between financial instruments and markets, subject to risk limits established and monitored by Corporate ALCO. All securities, foreign exchange transactions, commodity transactions and derivatives used in our trading businesses are carried at fair value. The Institutional Risk Committee establishes and monitors counterparty risk limits. The credit risk amount and estimated net fair value of all customer accommodation derivatives are included in Note 11 (Derivatives) to Financial Statements in this Report. Open at risk positions for all trading business are monitored by Corporate ALCO.

The standardized approach for monitoring and reporting market risk for the trading activities consists of value-at-risk (VAR) metrics complemented with factor analysis and stress testing. VAR measures the worst expected loss over a given time interval and within a given confidence interval. We measure and report daily VAR at a 99% confidence interval based on actual changes in rates and prices over the past 250 trading days. The analysis captures all financial instruments that are considered trading positions. The average one-day VAR throughout third quarter 2009 was $42 million, with a lower bound of $25 million and an upper bound of $54 million.

Market Risk Equity Markets

We are directly and indirectly affected by changes in the equity markets. We make and manage direct equity investments in start-up businesses, emerging growth companies, man