WELLS FARGO & CO/MN
Form 10-Q
October 30, 2008

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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, 2008
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 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 27, 2008
Common stock, $1-2/3 par value	3,325,244,156

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PART I FINANCIAL INFORMATION
FINANCIAL REVIEW
SUMMARY FINANCIAL DATA

		Quarter ended		% Change Sept. 30, 2008 from		Nine months ended		
($ in millions, except per share amounts)	**Sept. 30, 2008**	June 30, 2008	Sept. 30, 2007	June 30, 2008	Sept. 30, 2007	**Sept. 30, 2008**	Sept. 30, 2007	% Change
For the Period								
Net income	**$ 1,637**	$ 1,753	$ 2,173	(7)%	(25)%	**$ 5,389**	$ 6,696	(20)%
Diluted earnings per common share	**0.49**	0.53	0.64	(8)	(23)	**1.62**	1.97	(18)
Profitability ratios (annualized):								
Net income to average total assets (ROA)	**1.06%**	1.19%	1.59%	(11)	(33)	**1.21%**	1.76%	(31)
Net income to average stockholders equity (ROE)	**13.63**	14.58	18.22	(7)	(25)	**15.02**	19.15	(22)
Efficiency ratio (1)	**53.2**	51.1	57.5	4	(7)	**52.0**	58.0	(10)
Total revenue	**$ 10,379**	$ 11,459	$ 9,853	(9)	5	**$ 32,401**	$ 29,185	11
Dividends declared per common share	**0.34**	0.31	0.31	10	10	**0.96**	0.87	10
Average common shares outstanding	**3,316.4**	3,309.8	3,339.6		(1)	**3,309.6**	3,355.5	(1)
Diluted average common shares outstanding	**3,331.0**	3,321.4	3,374.0		(1)	**3,323.4**	3,392.9	(2)
Average loans	**$ 404,203**	$ 391,545	$ 350,683	3	15	**$ 393,262**	$ 334,801	17
Average assets	**614,194**	594,749	541,533	3	13	**594,717**	508,992	17
Average core deposits (2)	**320,074**	318,377	306,135	1	5	**318,582**	299,142	6
Average retail core deposits (3)	**234,140**	230,365	220,984	2	6	**230,935**	219,356	5
Net interest margin	**4.79%**	4.92%	4.55%	(3)	5	**4.80%**	4.79%	
At Period End								
Securities available for sale	**$ 86,882**	$ 91,331	$ 57,440	(5)	51	**$ 86,882**	$ 57,440	51
Loans	**411,049**	399,237	362,922	3	13	**411,049**	362,922	13
Allowance for loan losses	**7,865**	7,375	3,829	7	105	**7,865**	3,829	105
Goodwill	**13,520**	13,191	12,018	2	12	**13,520**	12,018	12
Assets	**622,361**	609,074	548,727	2	13	**622,361**	548,727	13
Core deposits (2)	**334,076**	310,410	303,853	8	10	**334,076**	303,853	10
Stockholders equity	**46,957**	47,964	47,566	(2)	(1)	**46,957**	47,566	(1)
Tier 1 capital (4)	**45,182**	42,471	38,107	6	19	**45,182**	38,107	19
Total capital (4)	**60,525**	57,909	51,625	5	17	**60,525**	51,625	17
Capital ratios:								
Stockholders equity to assets	**7.54%**	7.87%	8.67%	(4)	(13)	**7.54%**	8.67%	(13)
Risk-based capital (4)								
Tier 1 capital	**8.59**	8.24	8.17	4	5	**8.59**	8.17	5
Total capital	**11.51**	11.23	11.07	2	4	**11.51**	11.07	4
Tier 1 leverage (4)	**7.54**	7.35	7.26	3	4	**7.54**	7.26	4
Book value per common share	**$ 14.14**	$ 14.48	$ 14.30	(2)	(1)	**$ 14.14**	$ 14.30	(1)
Team members (active, full-time equivalent)	**159,000**	160,500	158,800	(1)		**159,000**	158,800	

Common Stock Price													
High	**$**	**44.68**	$	32.40	$	37.99	38	18	**$**	**44.68**	$	37.99	18
Low		**20.46**		23.46		32.66	(13)	(37)		**20.46**		32.66	(37)
Period end		**37.53**		23.75		35.62	58	5		**37.53**		35.62	5

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

(2) Core deposits are noninterest-bearing deposits, interest-bearing checking, savings certificates, market rate and other savings, and certain foreign deposits (Eurodollar sweep balances).

(3) Retail core deposits are total core deposits excluding Wholesale Banking core deposits and retail mortgage escrow deposits. To reflect the realignment of our corporate trust business from Community Banking into Wholesale Banking in first quarter 2008, balances for prior periods have been revised.

(4) See Note 19 (Regulatory and Agency Capital Requirements) to Financial Statements in this Report for additional information.

This Report on Form 10-Q for the quarter ended September 30, 2008, 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 significantly 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 and to the Risk Factors and Regulation and Supervision sections of our Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Form 10-K), filed with the Securities and Exchange Commission (SEC) and available on the SEC s website at www.sec.gov.

OVERVIEW

Wells Fargo & Company is a $622 billion diversified financial services company providing banking, insurance, investments, mortgage banking and consumer finance through banking stores, the internet and other distribution channels to consumers, businesses and institutions in all 50 states and in other countries. We ranked fifth in assets and third in market value of our common stock among our peers at September 30, 2008. When we refer to the Company, we, our or us in this Report, we mean Wells Fargo & Company and Subsidiaries (consolidated). When we refer to the Parent, we mean Wells Fargo & Company.

We earned $1.64 billion, or $0.49 per share, in third quarter 2008, after incurring $0.13 per share of previously announced write-downs for investments in Fannie Mae, Freddie Mac and Lehman Brothers. We built our credit reserves by an additional $500 million ($0.10 per share), bringing the allowance for credit losses to $8.0 billion, a $4.0 billion increase in the allowance since the disruption in credit markets began a year ago. Business momentum remained strong in the quarter, with double-digit loan and earning asset growth (both up 15% year over year), double-digit growth in core deposits (up 10% from September 30, 2007, and 30% (annualized) from June 30, 2008), growth in assets under management, primarily mutual funds (up 12% year over year), and a record 5.7 cross-sell in our retail banking business.

Our net interest margin remained among the best of the large bank holding companies at 4.79%, reflecting the decline in our funding costs since last year and continued above-market growth in core deposits. Finally, despite the strong growth in earning assets, investment write-downs and higher credit costs in the quarter, our capital ratios increased, with Tier 1 capital rising to 8.59%, among the strongest capital positions in the industry.

On October 3, 2008, we announced that we had signed a definitive agreement to acquire all outstanding shares of Wachovia Corporation (Wachovia) in a stock-for-stock transaction. Wachovia, based in Charlotte, North Carolina, had total assets of $764 billion at September 30, 2008, and is one of the nation s largest diversified financial services companies, providing a broad range of retail banking and brokerage, asset and wealth management, and corporate and investment banking products and services to customers through 3,300 financial centers in 21 states from Connecticut to Florida and west to Texas and California, and nationwide retail brokerage, mortgage lending and auto finance businesses. Under terms of the agreement, Wachovia shareholders will receive 0.1991 shares of Wells Fargo common stock in exchange for each share of Wachovia common stock. The agreement is subject to approval of Wachovia shareholders and the merger is expected to be completed by the end of 2008. For more

information about the pending merger with Wachovia, refer to the Company s Current Report on Form 8-K, including exhibits, filed on October 9, 2008, with the SEC and available on the SEC s website at www.sec.gov.

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 and diversified business model facilitate growth in strong and weak economic cycles, as we can grow by expanding the number of products our current customers have with us. Our average retail banking household now has a record 5.7 products with us. Our goal is eight products per customer, which is currently half of our estimate of potential demand. Our core products grew this quarter from a year ago, with average loans up 15%, average core deposits up 5% and assets under management or administration up 4%.

We believe it is important to maintain a well-controlled environment as we continue to grow our businesses. 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 have maintained strong capital levels to provide for future growth. Our stockholder value has increased over time due to customer satisfaction, strong financial results, investment in our businesses, consistent execution of our business model and the management of our business risks.

Our financial results included the following:

Net income for third quarter 2008 was $1.64 billion ($0.49 per share), compared with $2.17 billion ($0.64 per share) for third quarter 2007. Return on assets (ROA) was 1.06% and return on equity (ROE) was 13.63% for third quarter 2008, compared with 1.59% and 18.22%, respectively, for third quarter 2007.

Net income for the first nine months of 2008 was $5.39 billion, or $1.62 per share, down from $6.70 billion, or $1.97 per share, for the first nine months of 2007. ROA was 1.21% and ROE was 15.02% for the first nine months of 2008, and 1.76% and 19.15%, respectively, for the first nine months of 2007.

Net interest income on a taxable-equivalent basis was $6.44 billion for third quarter 2008, up 21% from $5.32 billion for third quarter 2007, driven by 15% earning asset growth combined with a 24 basis point increase in the net interest margin to 4.79%.

Noninterest income was $4.0 billion for third quarter 2008 down from $4.57 billion for third quarter 2007, including a $756 million decline in net investment gains. Net investment losses of $423 million in third quarter 2008 consisted of previously announced other-than-temporary impairment charges of $646 million for Fannie Mae, Freddie Mac and Lehman Brothers, an additional $247 million of other-than-temporary write-downs and $470 million of net realized gains.

Despite the 24% decline in third quarter 2008 in the S&P500® from a year ago, trust and investment fees declined only 5%. Card fees were up 7% in third quarter 2008 from a year ago

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due to continued growth in new accounts and higher credit and debit card transaction volume. Insurance revenue was up 33% in third quarter 2008 from a year ago due to customer growth, higher crop insurance revenues and the fourth quarter 2007 acquisition of ABD Insurance. Charges and fees on loans were up 8% in third quarter 2008, primarily reflecting strong commercial loan demand.

Mortgage banking noninterest income was $892 million in third quarter 2008, up $69 million from third quarter 2007. The owned mortgage servicing portfolio was $1.56 trillion at September 30, 2008, up 6% from a year ago. Mortgage applications of $83 billion in third quarter 2008 were down 13% from a year ago but at wider margins. Mortgage originations declined as a result of the combined slowdown in home purchase and refinance activities, and mortgage servicing benefited from the decline in mortgage prepayments. Third quarter 2008 results included a $75 million net gain related to changes in the value of our mortgage servicing rights (MSRs), net of hedge results (reflected in net servicing income).

Net unrealized losses on securities available for sale were $4.9 billion at September 30, 2008, compared with net unrealized gains of $680 million at December 31, 2007. The change in value was largely due to wider spreads on mortgage-backed securities, and an increase in market yields for the first nine months of 2008.

Revenue, the sum of net interest income and noninterest income, was $10.38 billion in third quarter 2008, up 5% from $9.85 billion in third quarter 2007. The write-downs for investments in Fannie Mae, Freddie Mac and Lehman Brothers reduced revenue growth by 7 percentage points. Revenue was up 11% to $32.4 billion for the first nine months of 2008. Many of our businesses continued to generate double-digit revenue growth from third quarter 2007, including asset-based lending, commercial banking, credit cards, mortgage banking, insurance, international and wealth management.

Noninterest expense was $5.52 billion for third quarter 2008, down $154 million, or 3%, from $5.67 billion for the same period of 2007. We continued to make investments in distribution and sales and service team members, adding over 1,000 platform bankers since last year end and adding 12 new banking stores in third quarter 2008 alone. We continued to be disciplined about our efforts to restrict expenses to revenue-creating opportunities while at the same time paring down other unit costs. The efficiency ratio was 53.2% in third quarter 2008 even after taking into account the other-than-temporary impairment charges on debt and equity investment securities.

Net charge-offs for third quarter 2008 were $2.0 billion (1.96% of average total loans outstanding, annualized), compared with $1.5 billion (1.55%) for second quarter 2008 and $892 million (1.01%) for third quarter 2007. During the first nine months of 2008, net charge-offs were $5.04 billion (1.71%), compared with $2.33 billion (0.93%) for the first nine months of 2007. Total provision expense in third quarter 2008 was $2.5 billion, including a $500 million credit reserve build, primarily related to higher projected losses in several consumer credit businesses and commercial real estate, as well as growth in the wholesale portfolios, bringing the allowance for credit losses to $8.0 billion, double its level from just before the disruption in credit markets began a year ago. As expected, consumer behavior continued to be influenced by weakness in residential real estate values. Additionally, the effects of higher energy prices and higher unemployment levels impacted the performance of the consumer loan portfolios during the quarter. Loan requests in our wholesale businesses have increased as quality borrowers are providing attractive business opportunities that are both well-structured and appropriately priced for risk.

Net charge-offs in the real estate 1-4 family first mortgage portfolio increased $123 million in third quarter 2008 from a year ago, including an increase of $53 million from Wells Fargo Financial s residential real estate portfolio. Credit card net charge-offs increased $185 million in third quarter 2008 from a year ago due to the effect of the current economic environment on consumers. Loss levels continued to increase in this credit cycle as the impacts from lower disposable income and unemployment weigh on the consumer. Net charge-offs in the auto portfolio in third quarter 2008 were up $58 million from a year ago and up $74 million linked quarter. While we remain optimistic about the positive impacts of process improvements and underwriting changes we made in the auto business in prior quarters, as well as our robust loss mitigation efforts, the economic environment continued to stress the consumer and influence loan performance.

Net credit losses in the real estate 1-4 family junior lien category were up $488 million for third quarter 2008 compared with third quarter 2007 and up $307 million linked quarter. A significant part of the sequential increase reflected the change in the National Home Equity Group (Home Equity) charge-off policy in second quarter 2008, which deferred an estimated $265 million of charge-offs from second quarter 2008. The fact that property values continued to drop in many markets directly impacted loss levels in this portfolio. Until residential real estate values stabilize, the Home Equity portfolio is expected to produce higher than normal loss levels.

Commercial and commercial real estate charge-offs increased $213 million in third quarter 2008 from third quarter 2007. Commercial and commercial real estate charge-offs include Business Direct (primarily unsecured lines of credit to small businesses), which increased $98 million in third quarter 2008 from a year ago and decreased $7 million linked quarter. The wholesale businesses continued to weather the turbulent credit environment. Commercial credits related to residential real estate and the consumer segment have shown some weakness, but remained within our expectations.

The provision for credit losses was $2.5 billion in third quarter 2008, $3.0 billion in second quarter 2008 and $892 million in third quarter 2007. The provision for third quarter 2008 included an additional $500 million in credit reserve build, primarily related to higher projected losses in several consumer credit businesses and commercial real estate, as well as growth in the wholesale portfolios. We have provided $3.9 billion in excess of net charge-offs since the beginning of fourth quarter 2007, including $2.5 billion in the first nine months of 2008. The allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, was $8.03 billion (1.95% of total loans) at September 30, 2008, compared with $5.52 billion (1.44%) at December 31, 2007, and $4.02 billion (1.11%) at September 30, 2007.

Total nonaccrual loans were $5.00 billion (1.22% of total loans) at September 30, 2008, up from $2.68 billion (0.70%) at December 31, 2007, and $2.09 billion (0.58%) at September 30, 2007, reflecting economic conditions, primarily in portfolios affected by residential real estate conditions and the associated impact on the consumer. A portion of the increase in nonaccrual loans from a year ago continued to relate to our active loss mitigation strategies at Home Equity, Wells Fargo Home Mortgage (Home Mortgage) and Wells Fargo Financial as we are aggressively working with customers to keep them in their homes or find alternative solutions to their financial challenges. Home builders, mortgage service providers, contractors, suppliers and others in the residential real estate-related segments continued to be stressed during this credit cycle. Additionally, as consumers cut back on discretionary spending, we are seeing some of the commercial loan portfolios dependent on their spending weaken. The $2.9 billion increase in

nonaccrual loans at September 30, 2008, from a year ago included $681 million in Wells Fargo Financial real estate, $578 million in Home Equity and $333 million in Home Mortgage.

Total nonperforming assets (NPAs) were $6.29 billion (1.53% of total loans) at September 30, 2008, compared with $3.87 billion (1.01%) at December 31, 2007, and $3.18 billion (0.88%) at September 30, 2007. Foreclosed assets were $1,240 million at September 30, 2008, $1,184 million at December 31, 2007, and $1,090 million at September 30, 2007. Foreclosed assets, a component of total NPAs, included $596 million, $535 million and $487 million of foreclosed real estate securing Government National Mortgage Association (GNMA) loans at September 30, 2008, December 31, 2007 and September 30, 2007, respectively, consistent with regulatory reporting requirements. The foreclosed real estate securing GNMA loans of $596 million represented 14 basis points of the ratio of NPAs to loans at September 30, 2008. 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. Until conditions improve in the residential real estate and liquidity markets, we will continue to hold more nonperforming assets on our balance sheet as it is currently the most economic option available. Increases in commercial nonperforming assets were also a direct result of the conditions in the residential real estate markets and general consumer economy.

The Company and each of its subsidiary banks continued to remain well-capitalized. The ratio of stockholders equity to total assets was 7.54% at September 30, 2008, 8.28% at December 31, 2007, and 8.67% at September 30, 2007. Our total risk-based capital (RBC) ratio at September 30, 2008, was 11.51% and our Tier 1 RBC ratio was 8.59%, exceeding the minimum regulatory guidelines of 8% and 4%, respectively, for bank holding companies. Our total RBC ratio was 10.68% and 11.07% at December 31, 2007 and September 30, 2007, respectively, and our Tier 1 RBC ratio was 7.59% and 8.17% for the same periods. Our Tier 1 leverage ratio was 7.54%, 6.83% and 7.26% at September 30, 2008, December 31, 2007 and September 30, 2007, respectively, exceeding the minimum regulatory guideline of 3% for bank holding companies.

Current Accounting Developments

On January 1, 2008, we adopted the following new accounting pronouncements:

- FSP FIN 39-1 Financial Accounting Standards Board (FASB) Staff Position on Interpretation No. 39, *Amendment of FASB Interpretation No. 39;*
- EITF 06-4 Emerging Issues Task Force (EITF) Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements;*
- EITF 06-10 EITF Issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements;* and
- SAB 109 Staff Accounting Bulletin No. 109, *Written Loan Commitments Recorded at Fair Value Through Earnings*.

On July 1, 2008, we adopted the following new accounting pronouncement:

- FSP FAS 157-3 FASB Staff Position No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*.

On April 30, 2007, the FASB issued FSP FIN 39-1, which amends Interpretation No. 39 to permit a reporting entity to offset the right to reclaim cash collateral (a receivable), or the obligation to return cash collateral (a payable), against derivative instruments executed with the same counterparty under the same master netting arrangement. The provisions of this FSP are effective for the year beginning on January 1, 2008, with early adoption permitted. We adopted FSP FIN 39-1 on January 1, 2008, and it did not have a material effect on our consolidated financial statements.

On September 20, 2006, the FASB ratified the consensus reached by the EITF at its September 7, 2006, meeting with respect to EITF 06-4. On March 28, 2007, the FASB ratified the consensus reached by the EITF at its March 15, 2007, meeting with respect to EITF 06-10. These pronouncements require that for endorsement split-dollar life insurance arrangements and collateral split-dollar life insurance arrangements where the employee is provided benefits in postretirement periods, the employer should recognize the cost of providing that insurance over the employee s service period by accruing a liability for the benefit obligation. Additionally, for collateral assignment split-dollar life insurance arrangements, an employer is required to recognize and measure an asset based upon the nature and substance of the agreement. EITF 06-4 and EITF 06-10 are effective for the year beginning on January 1, 2008, with early adoption permitted. We adopted EITF 06-4 and EITF 06-10 on January 1, 2008, and reduced beginning retained earnings for 2008 by $20 million (after tax), primarily related to split-dollar life insurance arrangements from the acquisition of Greater Bay Bancorp.

On November 5, 2007, the Securities and Exchange Commission (SEC) issued SAB 109, which provides the staff s views on the accounting for written loan commitments recorded at fair value under U.S. generally accepted accounting principles (GAAP). To make the staff s views consistent with current authoritative accounting guidance, SAB 109 revises and rescinds portions of SAB 105, *Application of Accounting Principles to Loan Commitments*. Specifically, SAB 109 states the expected net future cash flows associated with the servicing of a loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. The provisions of SAB 109, which we adopted on January 1, 2008, are applicable to written loan commitments recorded at fair value that are entered into beginning on or after January 1, 2008. The implementation of SAB 109 did not have a material impact on our results or the valuation of our loan commitments.

On October 10, 2008, the FASB issued Staff Position No. 157-3, which clarifies the application of FAS 157, *Fair Value Measurements*, in an inactive market and illustrates how an entity would determine fair value when the market for a financial asset is not active. The FSP states that an entity should not automatically conclude that a particular transaction price is determinative of fair value. In a dislocated market, judgment is required to evaluate whether individual transactions are forced liquidations or distressed sales. When relevant observable market information is not available, a valuation approach that incorporates management s judgments about the assumptions that market participants would use in pricing the asset in a current sale transaction would be acceptable. The FSP also indicates that quotes from brokers or pricing services may be relevant inputs when measuring fair value, but are not necessarily determinative in the absence of an active market for the asset. In weighing a broker quote as an input to a fair value measurement, an entity should place less reliance on quotes that do not reflect the result of market transactions. Further, the nature of the quote (for example, whether the quote is an indicative price or a binding offer) should be considered when weighing the available evidence. The FSP is effective immediately and applies to prior periods for which financial statements

have not been issued, including interim or annual periods ending on or before September 30, 2008. Accordingly, we adopted the FSP prospectively, beginning July 1, 2008. The adoption of the FSP did not have a material impact on our financial results or fair value determinations.

On October 14, 2008, the SEC s Office of the Chief Accountant (OCA), clarified its views on the application of other-than-temporary impairment guidance in FAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, to certain perpetual preferred securities. The OCA concluded that it would not object to a registrant applying an other-than-temporary impairment model to investments in perpetual preferred securities that possess significant debt-like characteristics that is similar to the impairment model applied to debt securities, provided there has been no evidence of deterioration in credit of the issuer. An entity is permitted to apply the OCA s views in its financial statements included in filings subsequent to the date of the letter. At September 30, 2008, based on the OCA guidance, we recorded no other-than-temporary impairment for our investments in investment-grade perpetual preferred securities that had no evidence of credit deterioration and that we have the intent and ability to hold to recovery.

On December 4, 2007, the FASB issued FAS 141R, *Business Combinations*. This statement requires an acquirer to recognize the assets acquired (including loan receivables), the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, to be measured 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. FAS 141R shall be applied prospectively to business combinations completed on or after January 1, 2009. Early adoption is not permitted.

On December 4, 2007, the FASB issued FAS 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. FAS 160 specifies that noncontrolling interests in a subsidiary are to be treated as a separate component of equity and, as such, increases and decreases in the parent s ownership interest that leave control intact are accounted for as capital transactions. It changes the way the consolidated income statement is presented by requiring that an entity s consolidated net income include the amounts attributable to both the parent and the noncontrolling interest. FAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. This statement should be applied prospectively to all noncontrolling interests, including any that arose before the effective date. The statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Early adoption is not permitted. We are currently evaluating the impact that FAS 160 may have on our consolidated financial statements.

On February 20, 2008, the FASB issued Staff Position FAS No. 140-3, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. FSP FAS 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction under FAS 140 unless certain criteria are met, including that the transferred asset must be readily obtainable in the marketplace. The provisions of this FSP are effective beginning on January 1, 2009, and shall be applied prospectively to initial transfers and repurchase

financings for which the initial transfer is executed on or after this date. Early application is not permitted.

On March 19, 2008, the FASB issued FAS 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*. 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. The provisions of FAS 161 are effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. Because FAS 161 amends only the disclosure requirements for derivative instruments and hedged items, the adoption of FAS 161 will not affect our consolidated financial results.

On September 12, 2008, the FASB issued Staff Position No. 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. This FSP is intended to improve disclosures about credit derivatives by requiring more information about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives. It amends FAS 133, *Accounting for Derivative Instruments and Hedging Activities*, to require disclosures by sellers of credit derivatives, including credit derivatives embedded in hybrid instruments. The FSP also amends FASB Interpretation No. 45*, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others* (FIN 45), to require an additional disclosure about the current status of the payment/performance risk of a guarantee. The provisions of the FSP that amend FAS 133 and FIN 45 are effective for reporting periods (annual or interim) ending after November 15, 2008. Because the FSP amends only the disclosure requirements for credit derivatives and certain guarantees, the adoption of the FSP will not affect our consolidated financial results.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are fundamental to understanding our results of operations and financial condition, because some accounting policies require that we use estimates and assumptions that may affect the value of our assets or liabilities and financial results. Five 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, the valuation of residential mortgage servicing rights (MSRs) and financial instruments, pension accounting and income taxes. Management has reviewed and approved these critical accounting policies and has discussed these policies with the Audit and Examination Committee of the Board of Directors. These policies are described in Financial Review Critical Accounting Policies and Note 1 (Summary of Significant Accounting Policies) to Financial Statements in our 2007 Form 10-K.

FAIR VALUE OF FINANCIAL INSTRUMENTS

We use fair value measurements to record fair value adjustments to certain financial instruments and determine fair value disclosures. (See our 2007 Form 10-K for the complete critical accounting policy related to fair value of financial instruments.)

Approximately 22% of total assets ($134.7 billion) at September 30, 2008, and 22% of total assets ($123.8 billion) at December 31, 2007, consisted of financial instruments recorded at fair value on a recurring basis. At September 30, 2008, approximately 74% of these financial instruments used valuation methodologies involving market-based or market-derived information, collectively Level 1 and 2 measurements, to measure fair value. The remaining 26% of these financial instruments (6% of total assets) were measured using model-based techniques, with primarily unobservable inputs.

Our financial assets valued using Level 3 measurements consisted of MSRs, asset-backed securities collateralized by auto leases and cash reserves, certain mortgages held for sale (MHFS) and certain debt securities available for sale. While MSRs and our asset-backed securities collateralized by auto leases and cash reserves do not have observable market data and therefore are classified as Level 3, significant judgment may be required to determine whether certain other assets measured at fair value are included in Level 2 or Level 3. For example, we closely monitor market conditions involving assets that have become less actively traded, such as MHFS, non-agency mortgage-backed securities and certain other debt securities, including collateralized debt obligations. If fair value measurement is based upon recent observable market activity of such assets or comparable assets (other than forced or distressed transactions) that occur in sufficient volume, and do not require significant adjustment using unobservable inputs, those assets are classified as Level 2; if not, they are classified as Level 3. Making this assessment requires significant judgment. In third quarter 2008, $456 million of debt securities available for sale and, in the first nine months of 2008, $2.2 billion of debt securities available for sale and $4.3 billion of mortgages held for sale were transferred from Level 2 to Level 3 because significant inputs to the valuation became unobservable, largely due to reduced levels of market liquidity.

We use prices from independent pricing services and to a lesser extent, indicative (non-binding) quotes from independent brokers, to measure fair value of our investment securities. See Note 13 (Fair Values of Assets and Liabilities) for the amount and fair value hierarchy classification of those securities. We validate prices received from pricing services or brokers using a variety of methods, including, but not limited to, comparison to secondary pricing services, corroboration of pricing by reference to other independent market data such as secondary broker quotes and relevant benchmark indices, and review of pricing by Company personnel familiar with market liquidity and other market related conditions. Generally, we do not adjust prices received from pricing services or brokers, unless it is evident the fair value measurement is not consistent with FAS 157.

Approximately 2% of total liabilities ($10.8 billion) at September 30, 2008, and 0.5% ($2.6 billion) at December 31, 2007, consisted of financial instruments recorded at fair value on a recurring basis. Liabilities valued using Level 3 measurements were $550 million at September 30, 2008. See Note 13 (Fair Values of Assets and Liabilities) to Financial Statements in this Report for additional detail for third quarter 2008. See Note 8 (Securitizations and Variable Interest Entities) to Financial Statements in our 2007 Form 10-K for a detailed discussion of the key assumptions used to determine the fair value of our MSRs and the related sensitivity analysis.

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

			Quarter ended September 30,			
			2008			2007
(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	**$ 3,463**	**2.09%**	**$ 18**	$ 4,219	5.01%	$ 53
Trading assets	**4,838**	**3.72**	**46**	4,043	3.69	37
Debt securities available for sale (3):						
Securities of U.S. Treasury and federal agencies	**1,141**	**3.99**	**11**	871	4.27	10
Securities of U.S. states and political subdivisions	**7,211**	**6.65**	**124**	5,021	7.31	90
Mortgage-backed securities:						
Federal agencies	**50,528**	**5.83**	**731**	52,681	6.03	794
Private collateralized mortgage obligations	**21,358**	**5.82**	**346**	4,026	6.22	62
Total mortgage-backed securities	**71,886**	**5.83**	**1,077**	56,707	6.05	856
Other debt securities (4)	**12,622**	**7.17**	**248**	5,822	7.67	114
Total debt securities available for sale (4)	**92,860**	**6.06**	**1,460**	68,421	6.26	1,070
Mortgages held for sale (5)	**24,990**	**6.31**	**394**	35,552	6.59	586
Loans held for sale (5)	**677**	**6.95**	**12**	960	7.79	19
Loans:						
Commercial and commercial real estate:						
Commercial	**100,688**	**5.92**	**1,496**	79,713	8.24	1,655
Other real estate mortgage	**43,616**	**5.60**	**615**	32,641	7.42	610
Real estate construction	**19,715**	**4.82**	**238**	16,914	7.94	338
Lease financing	**7,250**	**5.48**	**100**	6,026	5.78	87
Total commercial and commercial real estate	**171,269**	**5.69**	**2,449**	135,294	7.90	2,690
Consumer:						
Real estate 1-4 family first mortgage	**76,197**	**6.64**	**1,265**	63,929	7.26	1,162
Real estate 1-4 family junior lien mortgage	**75,379**	**6.36**	**1,206**	73,476		