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Federal Reserve Bank Wachovia 2007 Risk Assessment

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Wachovia Corporation
2007 RISK ASSESSMENT

Top Tier Institution:	Wachovia Corporation
Business Lines:	General Bank Group (GBG) Corporate Investment Bank (CIB) Capital Management Group (CMG) Wealth Management Group (WMG)
Central Point of Contact:	Richard F. Westerkamp, Jr.
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Last Update:	July 12, 2007

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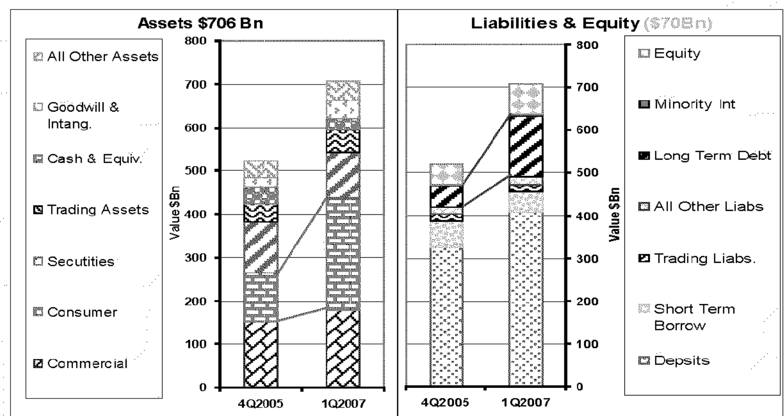
I. Institutional Overview

Executive Summary

Wachovia	3/31/07	RSSD 1073551	2006
Assets:	$706Bn	NII :	$15Bn
Loans:	$422Bn	NIM:	3.12%
NPA / Loans	0.40%	NonInt. Inc.:	$15Bn
Deposits:	$408Bn	Revenue:	$30Bn
Capital:	$70Bn	NonInt. Exp.:	$17Bn
Tier1 RBCR:	7.35%	Net Income:	$8Bn
Total RBCR:	11.41%	ROAA	1.34%

Wachovia Corporation experienced significant growth through acquisition in 2006 and the company is now the nation's fourth-largest financial holding company both in asset size and market capitalization (previously Wells Fargo's market capitalization was larger). Consolidated assets at the multi-state, multi-bank, holding company grew 36% over the year, as the corporation absorbed two significant lending acquisitions. As of 03/31/07, consolidated assets stood at $706.4 billion. The scale and scope of these acquisitions shifted the asset mix of the institution and accelerated its geographic expansion. The pace of development has continued in 2007 with Wachovia announcing an additional major acquisition, the national retail broker A.G. Edwards.

Over recent years, Wachovia has established itself as a well diversified financial institution. The country's third largest institution by deposit market share and the largest retail bank franchise on the East coast, Wachovia already encompasses the nation's third largest retail brokerage firm and a top five personal trust provider, and is also a market leader in treasury management, commercial real estate and structured products. Of the corporation's $30 billion revenue in 2006, some 49% came from noninterest sources, and only 53% was generated by the corporation's General Banking business line. Access to capital market related revenues has aided the corporation in the face of ongoing interest margin contraction. Wachovia achieved net income of $7.8 billion in 2006, up 17% on 2005, and is forecasting net income of $9.4 billion in 2007.



Historically biased towards commercial lending, the acquisition of auto-lender WestCorp in 1Q06 and the GoldenWest Financial mono-line retail mortgage provider in 4Q06 shifted at least one side of the balance sheet to a more consumer focus. In a reversal of the position from one year ago, the majority (60%) of the $422 billion loan portfolio now constitutes consumer loans (see chart). Wachovia has also maintained an industry reputation for high asset quality. The WestCorp acquisition represented a move into higher risk/return subprime assets, and this has been reflected in asset quality trends. In addition to growing substantially Wachovia's non-traditional consumer mortgage book, the acquisition of GoldenWest injected some much needed deposits. Organic deposit growth proved to be elusive in 2006 and expansion-driven liquidity needs spurred significant debt issuance. The gain of GoldenWest's branch network also expanded the geographic footprint of the corporation westward, with significant penetration into California. Wachovia now operates 3,400 retail banking offices in 21 states and Washington, DC, while Wachovia Securities currently has offices across 47 states. The proposed fourth-quarter 2007 integration of A.G. Edwards into Wachovia Securities would add 740 brokerage offices nationwide and increase client assets to over $1.1 trillion. Simultaneously, the corporation's modest international presence is undergoing expansion, not only through operational business lines where it has proven domestic competence, but also through IT process offshoring and foreign debt issuance.

Ongoing challenges for 2007 include yield curve pressures, the performance of the consumer mortgage market, deposit growth, the integration of GoldenWest and A.G. Edwards, the development of European investment banking operations, and the resourcing of infrastructure developments in light of the institution's expanding scope and complexity. Wachovia maintains a moderate inherent risk profile, satisfactory risk management and an RFI/C(D) rating for 2006 of 222/2(2).

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Introduction

In setting the context for the Risk Assessment Program, this Institutional Overview describes the strategies and structures of Wachovia Corporation, together with its performance and regulatory framework. The first section outlines the corporate strategy of the institution, and this is followed by a description of how this strategy is implemented through the corporation's various lines of business. The extent of the achievement of this implementation is captured in a section on revenues and financial risk drivers. The final three sections outline the risk management framework and legal entity structures of the corporation, together with the broader regulatory scheme faced by the institution.

Corporate Strategy

Wachovia's overarching corporate strategy is to strengthen and grow the core activities within its established, diversified business portfolio with an emphasis on customer service and retention. This four business line portfolio generates diversified revenues from Wachovia's traditional banking presence, targeted high-net-worth services, corporate and investment banking activities, and retail brokerage and assets management. The organizational structures of the four business lines are described in detail in the next section, which also outlines the strategic value propositions of each business. Strategies are implemented within the business lines in pursuit of targets for revenue growth, merger-derived efficiencies, and expense reduction initiatives. Divisional strategies increasingly recognize the need to generate revenue through cross-selling capabilities between the business lines – managed through 'Client Partnership' arrangements. One key strategic resource that is utilized by these cross-selling propositions, is the corporation's competence in generating customer satisfaction. (Wachovia has been voted #1 in customer service among banking peers for six straight years).

At the corporate level, Wachovia has recently trended towards revenue growth activities which have a higher risk / return profile, whilst simultaneously building scale and diversifying geographic scope.

Historically, Wachovia has been viewed as an industry leader in asset quality. This emphasis has been underlined through the cultural embedding of an economic capital performance management system since 2001. This corporate risk / return focus has underpinned the strategy of opportunistically growing the balance sheet with lower risk assets. The operational expression of this strategy is seen in the cultivation of volume businesses that retain fewer risky assets on the balance sheet.

The successful integration of traditional banking SouthTrust Corp. during 2005, together with its associated asset sales, did little to shift the corporation's risk profile. However, in March 2006, Wachovia acquired WestCorp and its subsidiary WFS Financial. This acquisition significantly extended the corporation's presence within the auto lending and sub-prime markets. (The ratio of NPAs to loans has trended upwards since that point, to stand at 0.40% of loans as of 03/31/07). The acquisition also provided Wachovia with its first 19 branches in southern California.

Additionally in the first quarter of 2006, Wachovia reentered the credit card business as a direct issuer following the merger of MBNA with Bank of America. Credit card consumer loan balances have now grown to $1.5 billion.

Wachovia's October 2006 acquisition of GoldenWest Financial Corp., took the two themes of geographic expansion and consumer lending growth, and multiplied them many fold. California based GoldenWest was the second largest savings bank in the nation and the only AA rated thrift institution. The thrift's 290 branches consolidated Wachovia's "U-Shaped" banking franchise, enabling it to pursue deposit and lending growth not only along the East coast, but also West through Texas to the fast growing urban centers of California. Furthermore, GoldenWest was also a mono-line, niche player in option-ARM products, with well respected underwriting processes. Wachovia's consumer loan balances jumped 96% during the fourth quarter of 2006, establishing the new 60/40 consumer to commercial split in loan balances. Although the consumer mortgage market has softened since the inception of the acquisition, Wachovia sees significant long term advantage in the application of the GoldenWest model throughout its lending footprint.

Recent Growth Strategies

- 2001: After a bitter contest with SunTrust, First Union Corp. acquires legacy Wachovia Corp.
- 2003: Joint venture with Prudential Financial Inc. creates nation's #3 retail broker.
- 2004: The acquisition of $53Bn SouthTrust Corp., Birmingham, AL, creates the nation's 4th largest FHC by assets.
- 2005: Purchase of correspondent banking business of Union Bank of California and AmNet Mortgage.
- 2006: WestCorp acquisition makes Wachovia 9th largest auto finance lender.
- 2006: GoldenWest acquisition broadens geographic scope and further shifts lending bias towards consumers.
- 2007: Proposed A.G. Edwards acquisition to form the #2 national retail brokerage firm.

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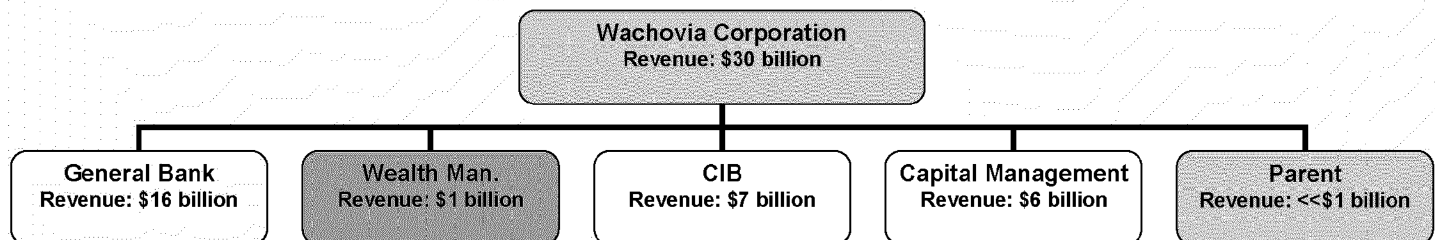
While having no current strategic plans to acquire bank operations in the Mid-West, Wachovia announced in March 2007 its intention to move the headquarters of its retail broker operations to Missouri as it acquires St. Louis based A.G. Edwards. The proposed acquisition, due to close in 4Q07, will turn Wachovia Securities into the nation's second largest retail broker firm with $1.1 trillion of client assets.

Wachovia's geographic expansion has also included new initiatives overseas, in pursuit of new business, funding diversification and cost restraint. The establishment of an Irish bank in 2007 is seen as a significant step towards the replication of mature investment banking businesses in the European Union. In 2006, Wachovia additionally achieved greater international diversification in its funding streams with the successful issuance of Euro and Sterling denominated senior and subordinated debt. In parallel with these growth and funding strategies, Wachovia is drawing to the end of its 3-year strategic initiative to limit noninterest expense growth relative to revenues. The key themes of the initiative have been end-to-end process improvement, staff efficiency, and outsourcing / offshoring, which has been a growing strategic approach.

The future prospects for the continued financial strength of the corporation remain good. Continuing financial risks includes yield-curve pressures, mortgage market softening, limited deposit growth, and some negative migration in asset quality. However, revenue streams remain well diversified, with 49% of 2006 annual revenues being in the form of noninterest income, and overhead ratios (excluding merger costs) are consistently declining. Although increasingly dependent on restricted-core and supplementary capital elements, capital levels at the corporation remain satisfactory.

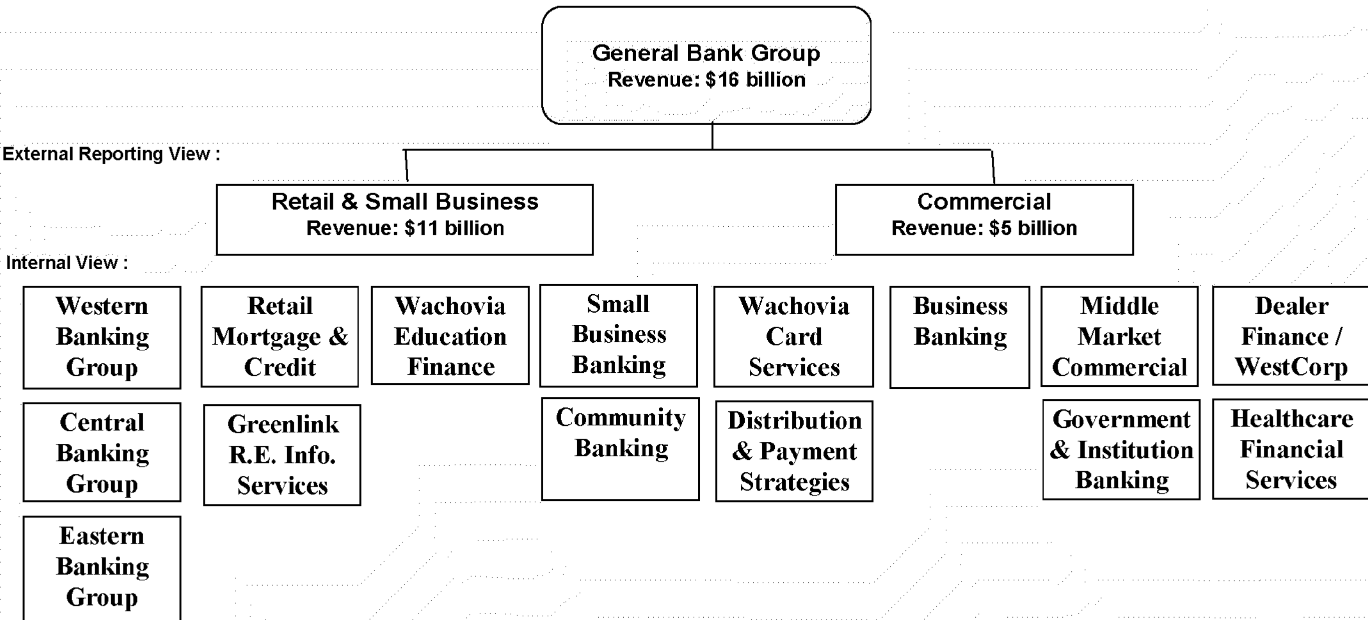
Organizational Structures, Business Line Strategies & Significant Activities

Wachovia is structured into four main lines of business: the General Bank, Wealth Management, Capital Management, and the Corporate and Investment Bank (CIB); the structures of which are described in this section. These four businesses are overseen by the parent financial holding company and centralized treasury, risk management, human resources, legal and information technology functions.



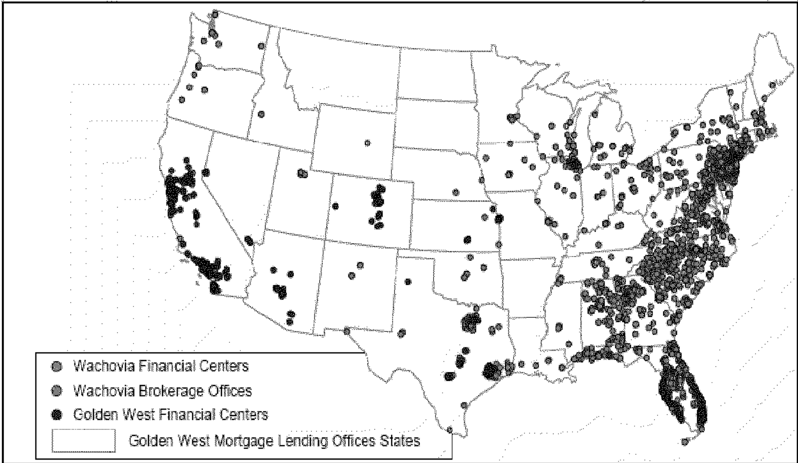
The General Bank Group (GBG) Structure

The General Bank serves 11 million households and businesses in 21 states and Washington DC, through 3,400 financial centers, 5,200 automated teller machines, telephone banking and the Internet. GBG provides a broad range of products to individuals, corporations and government institutions and seeks to address the needs of three core markets: retail and small business with annual revenues up to $3 million; business banking customers with revenues between $3 million and $15 million, and commercial customers with revenues up to $250 million. Retail deposit and lending products include checking, savings and money market accounts, time deposits, home equity, residential mortgage, student loans, credit cards and personal loans; and investment products include mutual funds, IRAs and annuities. Middle-market customers receive commercial deposit and lending solutions, as well as access to asset management, global treasury management, and capital markets products and services through partnerships with Capital Management, Wealth Management, and CIB. The figure below shows GBG's business line revenues and an array of its operational segments.



The largest bank franchise in the Southeast, GBG projects a dominant presence along the East coast and is ranked third nationwide on the basis of deposit share.

The merger with GoldenWest Financial in October 2006 incorporated the nation's second largest savings bank into the GBG structure. The thrift's 290 branches (marked in red on the figure shown right) gave Wachovia expanded coverage into Arizona, Colorado, Kansas, Nevada and Illinois, and bolstered its presence in California, Florida, New Jersey, New York and Texas. The acquisition added $70 billion to average core deposits and $126 billion to average loans of GBG in the last quarter of 2006.



The executive reporting structure within GBG now operates over three geographic regions: Western, Central and Eastern regions. The Eastern region has group retail banking executives over the subdivisions of the Northeast (Atlantic, Mid-Atlantic, Carolinas and Virginia) and Southeast (Georgia, Mid-South and Florida).

GBG additionally absorbed the March 2006 WestCorp and WFS Financial acquisition, which added $528 million to average deposits over the first quarter 2006 within the Retail and Small Business sub-segment, and $209 million average deposits plus $13 billion of loans within the Commercial sub-segment.

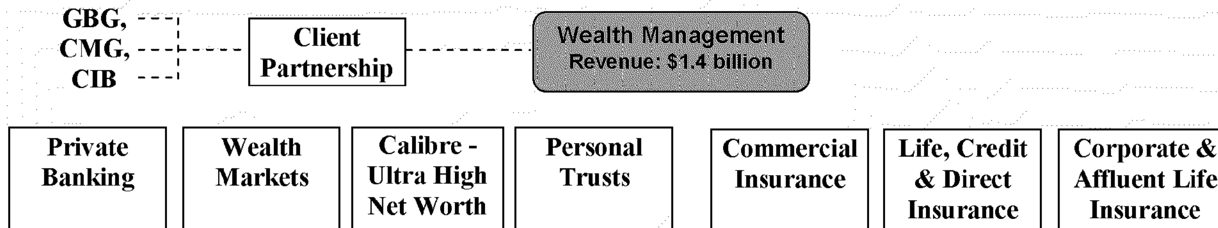
For the retail consumer, GBG seeks to provide products for all life stages, including savings, mortgages and retirement products. The retail sales management processes focus on customer needs assessment surrounding day-to-day money management, major purchase planning, financial future planning and unexpected event planning. The implementation of the business model stresses retail customer satisfaction and loyalty. Wachovia has been voted number one in customer satisfaction relative to banking peers for six years in succession. The lead middle-market lender within its footprint and a top ten nationwide mortgage lender, GBG's strategy is driven by the diversity of its product offerings and markets. GBG additionally seeks to address the needs of business of all sizes, with business checking, treasury services, global trade services, loans, leases and capital market products.

GBG's average core deposits for the first quarter of 2007 were $292.4 billion, with average loans of $326.8 billion. Retail & Small Business sub-segment loans averaged $218.4 billion and the Commercial sub-segment $108.4 billion. The

group's $15.7 billion annual revenue for 2006 was derived primarily from its retail and small business operation, which contributed $11.0 billion; in the form of $7.8 billion net interest income and $3.2 billion in fee and other income.

Wealth Management Structure

In managing client financial assets, the Wealth Management business line deals with wealth creation, wealth preservation and generational transfers. The division's strategy is based around the use of dedicated relationship managers who coordinate with multiple financial advisors to meet client needs. The structure of the business line is shown below.



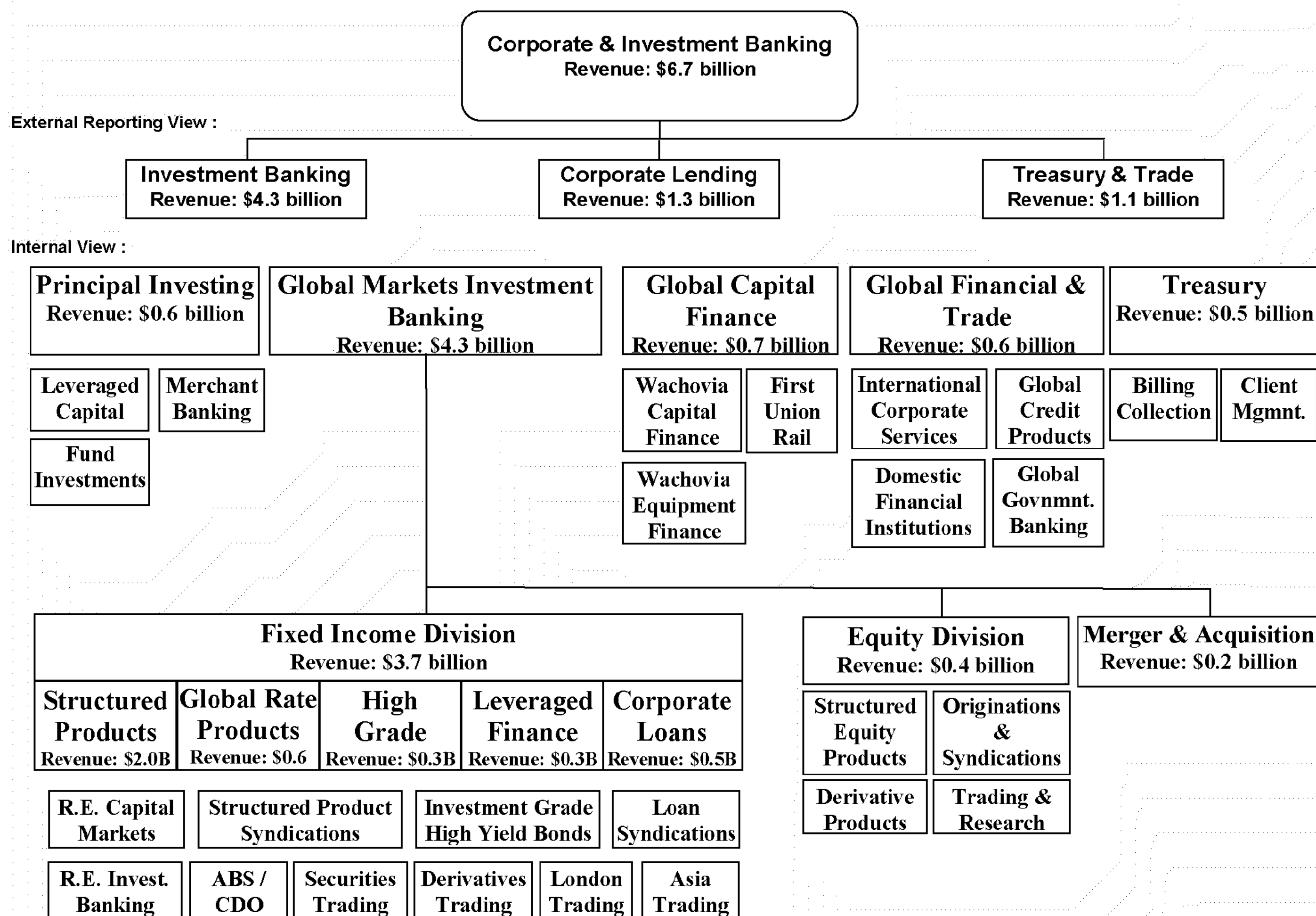
Wealth Management is the fifth largest US wealth manager, based on private banking assets under management, including clients having in excess of $1 million in investable assets with Wachovia Securities and Wealth Management. The division is also one of the oldest and largest personal trust providers in the US and a top ten commercial insurance brokerage firm. Through a separate practice called Calibre, it provides sophisticated investment and generational transfer solutions to ultra high net worth families. Wealth additionally provides customized loans and capital solutions to meet the financial needs of its high-net-worth clients. Credit facilities and services are tailored to wealth clients and include commercial loans, revolving lines, installment loans, and mortgages. The division is a specialist in the provision of marine and aircraft financing. Wachovia Insurance Services provides commercial property insurance brokerage, risk management services, employee benefits, life insurance and personal insurance across 19 states and Washington D.C.

In April 2007, Wealth Management, while continuing to operate as a separate business line, merged with GBG's Private Advisory Group, which was renamed Private Banking. Clients having $250,000 to $5 million in investable assets are served by Private Banking. Clients having in excess of $5 million in investable assets (or having $10 million net worth) are served by Wealth Markets. The specialist division Calibre serves clients with $50 million or more in investable assets. Wealth Management operates with some 940 wealth management advisors. Acting as the client relationship manager, Wealth Management draws on the services of other business lines, including Capital Management's asset management services, through client partnership.

Annual Wealth Management revenues for 2006 were $1.4 billion, of which 56% is derived from fees and other income. As of the first quarter 2007, the business line had $135.6 billion of investment assets under administration and has responsibility over $76 billion of the assets currently under management within the Capital Management business line. For the first quarter of 2007, average loan balances amounted to $17.2 billion and average core deposits were $14.0 billion.

Corporate and Investment Bank Structure

CIB's strategy is based on the linkage between a leading treasury services platform and the corporation's capital-raising capabilities. Operating under the Wachovia Securities brand, Wachovia Capital Markets and its affiliates service corporations with annual revenues over $250 million, financial institutions and institutional investors, and provide advisory, capital raising, structuring, research and execution services. The business line also provides portfolio management, fixed income and equity sales and trading. CIB engages with a full set of capital market products. The business line is a market leader in domestic CMBS loan contribution and servicing. It is the No. 3 lead manager for U.S. collateralized debt obligations. CIB additionally incorporates a top 3 treasury management provider, as well as a top 3 U.S. asset-based lending lead arranger and provides global correspondent banking services. The figure below represents the main structural elements of CIB showing the revenue contributions of its sub-segments.



As can be seen from the above figure, of CIB's $6.7 billion annual revenue, some $4.3 billion is generated by the Global Markets Investment Banking (GMIB) segment. GMIB revenue production is dominated by the Fixed Income division ($3.7 billion). Within Fixed Income, $2.0 billion of revenue comes from the Structured Products sub-segment. Structured Products incorporates commercial real estate and ABS finance, ABS conduits, large loans, structured asset finance and leasing. Global Rate products captures derivatives marketing and institutional sales, commodity derivatives and global foreign exchange. Total CIB trading-related revenues for 2006 amounted to $1.1 billion, of which $0.5 billion were profits on the trading account. CIB's second largest revenue generator is the Global Capital Finance segment which generates $0.7 billion dollars per year, through asset backed lending and leasing.

The Treasury Services division offers customers a suite of integrated payables and receivables solutions, including electronic check conversion, accounts receivable conversion, a full range of ACH services, image technology, a national wholesale and retail lockbox network and international treasury solutions.

During 2006, CIB expanded its real estate capital markets platform in Europe and commenced delivering commercial mortgage loan and REPO finance products in the UK and Germany. A securitization, structured finance and REPO warehouse business has been developed in London, with origination throughout Europe being driven from the Frankfurt and London offices. In 2007, Wachovia was granted permission to establish a foreign bank based in Dublin, Ireland. Wachovia Bank International will conduct passported activities within the European Union, primarily Structured Products' Real Estate Capital Markets securitizations and commercial loan servicing.

For the first quarter 2007, average loan balances within CIB stood at $40.9 billion, with lending commitments of $106.6 billion. Average core deposits were $28.9 billion.

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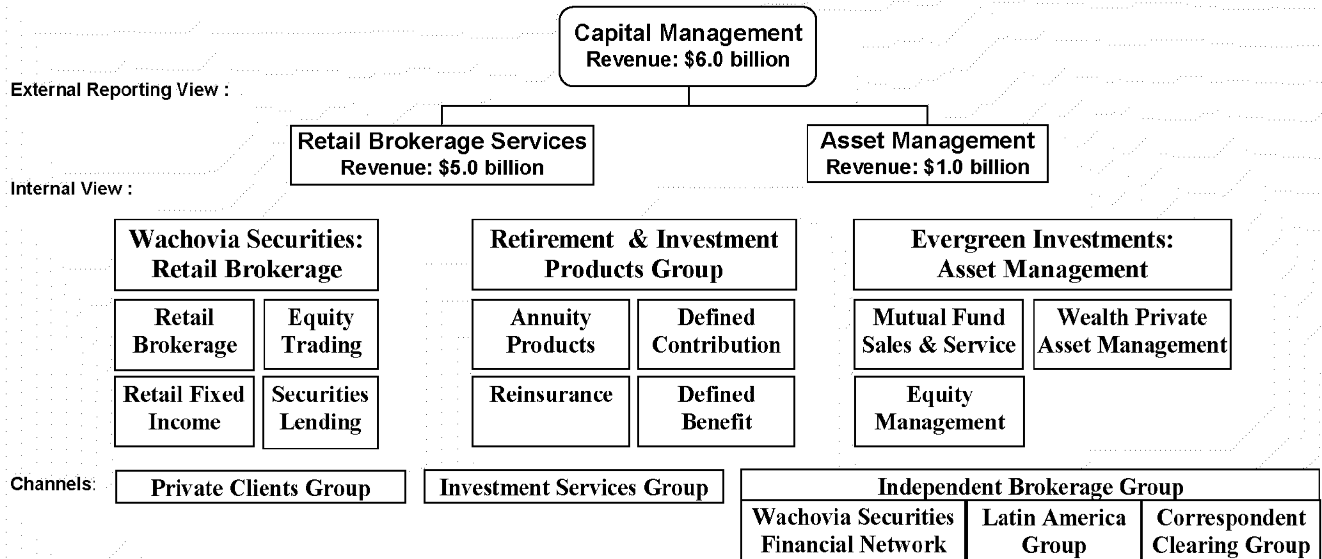
Capital Management Structure

Capital Management Group (CMG) provides both proprietary and nonproprietary investment and retirement products, working with both retail and institutional clients. Wachovia Securities, whose retail brokerage operations fall within the Capital Management business line, currently operates through 2,700 offices in 49 states, Washington DC and Latin America. The other main business line within Capital Management is Evergreen Investments, a large and diversified asset management operation which, again, services both retail and institutional investors. The structure of Capital Management and the revenue contributions from its segments are shown below.



CMG's Retail Brokerage operations currently constitute the third-largest full-service U.S. brokerage, with client assets as of March 2007 of $773 billion. The proposed acquisition of national independent brokerage firm A.G. Edwards would expand client assets to over $1.1 trillion. The business line currently employs 10,600 registered representatives in 768 brokerage offices and 1,850 banking centers. The Retail Brokerage Services sub-segment, as shown above, includes the results of the Wachovia Securities brand retail activities, which are the combination of Wachovia's and Prudential Financial's retail brokerage operations. Wachovia Securities LLC is currently headquartered in Richmond, VA, but in conjunction with the proposed A.G. Edwards acquisition, the combined firm will be headquartered in St. Louis, MO. The proposed integration of the firm would be complete by the end of 2009. Wachovia Securities additionally operates in conjunction with two further broker dealers, Wachovia Securities Financial Network LLC and First Clearing LLC. As shown in the figure above, Retail Brokerage uses multiple channels including the traditional retail brokerage, Private Client Group; the Wachovia bank channel, Investment Services, and independent financial advisors and correspondent firms. Wachovia has strongly pursued the migration of its clients from transaction fee based accounts to managed accounts which generate recurring income streams. In 1Q07, 60% of revenue came from recurring sources and the firm has the strategic objective of achieving a 70% level.

The Asset Management sub-segment has $315 billion of assets under management of which 45% are in fixed income securities, 34% are equities, and 21% are money market. Asset Management is also a top twenty mutual fund manager with $110 billion of mutual fund assets under management. The majority of its products and services are marketed through Evergreen Investments, based in Boston, MA and Charlotte, NC. In 2006, the firm launched Wachovia Global Asset Management, the brand name under which Evergreen distributes institutional services to non-US markets. Last year Evergreen additionally acquired majority interest in Metropolitan West Capital Management LLC, an intrinsic value asset management firm based in Newport Beach, CA. The former Metropolitan West Securities, now Wachovia Global Securities Lending, is a specialist securities lending and short term asset management firm. Also in 2006, Wachovia completed the acquisition of the defined contribution recordkeeping business of Ameriprise Financial Inc. of Minneapolis, adding significant scale to the Retirement Services segment and expanding its national reach. In February 2007, Wachovia acquired London based European Credit Management to expand Evergreen's international distribution capability. A.G. Edwards is also a provider of asset management services and, under the proposed acquisition, its operations will be folded into the business segment.

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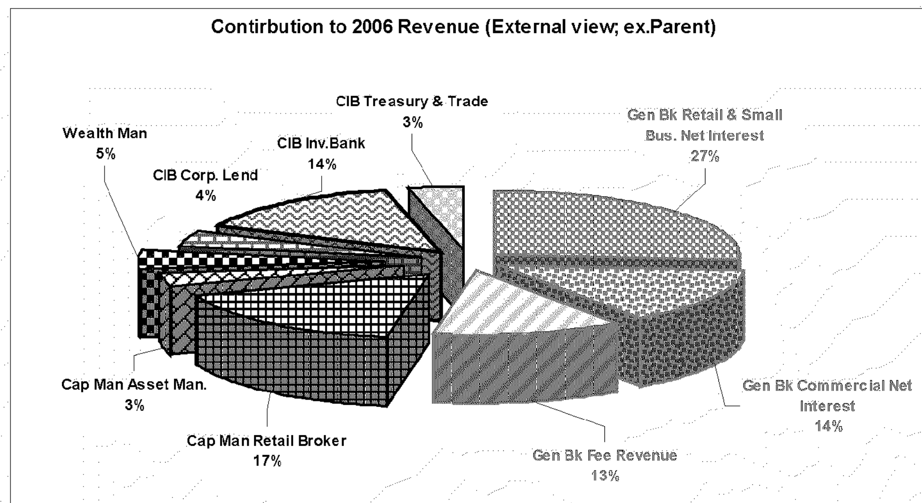
Revenue and Risk Drivers

Wachovia's total revenue for the year 2006 was $30.0 billion, being split between net interest income of $15.4 billion (51% of revenue) and noninterest income was $14.6 billion (49%). Net income for the year was $7.8 billion, or $4.72 per share. The following table shows the main revenue contributions from the business lines described in the previous section. The table also includes Wachovia's assessment of the business lines' relative risks in the form of economic capital allocations.

Revenue and Earnings Contributions with Average Economic Capital Allocations:

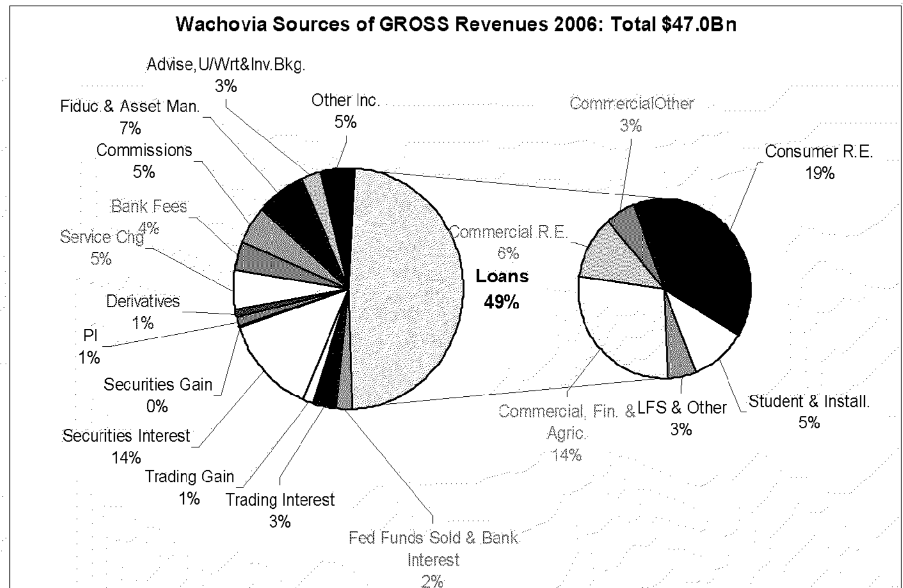
Full-Year 2006	Revenue 2006	%	Net Income	%	Average Economic Capital Over Period ($Bn)				%	RAROC %
Business Line	($Bn)		($Bn)		Credit	Market	Other	Total		
GBG Retail & Small Biz.	10.9	36%	3.3	42%						
GBG Wholesale	4.8	16%	1.9	24%						
General Bank	**15.7**	**52%**	**5.2**	**66%**	7.0	0.1	2.1	**9.2**	**45%**	**54.6%**
Wealth Management	**1.4**	**5%**	**0.3**	**4%**	0.3	-	0.2	**0.5**	**2%**	**48.1%**
CIB Principal Investing	0.6	2%	0.3	4%						
CIB Fixed Income Div.	3.7	12%	1.4	18%						
CIB Equity Division	0.4	1%	(0.0)	-						
CIB M&A	0.2	1%	0.1	1%						
CIB Inv. Bank Other	0.0	-	(0.2)	-3%						
CIB Capital Finance	0.7	2%	0.2	3%						
CIB Financial & Trade	0.6	2%	0.1	2%						
CIB Treasury	0.5	2%	0.1	1%						
CIB	**6.7**	**22%**	**2.0**	**26%**	4.1	1.1	1.2	**6.4**	**31%**	**28.7%**
CMG. Retail Brokerage	5.0	17%	0.8	10%						
CMG Asset Management	1.0	3%	0.1	1%						
Capital Management	**6.0**	**20%**	**0.9**	**11%**	0.3	-	1.3	**1.6**	**8%**	**58.8%**
Parent (& Risk Diversification)	**0.2**	**1%**	**(0.6)**	**-7%**	0.9	3.1	(1.2)	**2.8**	**14%**	**(8.49)%**
Consolidated 2006	**30.0**	**100%**	**7.8**	**100%**	12.6	4.3	3.6	**20.5**	**100%**	**38.12%**
First Quarter 2007	**($B)**	**%**	**($B)**	**%**	Credit	Market	Other	**Total**	%	
General Bank	4.6	56%	1.5	66%	10.0	0.1	2.5	12.6	52%	48.22%
Wealth Management	0.4	5%	0.1	4%	0.3	-	0.3	0.6	2%	43.63%
CIB	1.5	18%	0.4	17%	4.2	1.4	1.5	7.1	29%	20.10%
Capital Management	1.7	21%	0.3	13%	0.2	-	1.4	1.6	7%	77.48%
Parent (& Risk Diversification)	-	-	-	-	0.7	3.6	(1.9)	2.4	10%	17.04%
Consolidated 1Q07	**8.2**	**100%**	**2.3**	**100%**	15.4	5.1	3.8	**24.3**	**100%**	**38.72%**

The chart right shows how the principle activities of the business lines, excluding the Parent, compare in terms of revenue generation. The relative importance of net interest and noninterest income within GBG is also shown.



As noted above, Wachovia's corporate strategy is underpinned by the diversity of its sources of revenue from the various business lines. The General Banking Group derives 52% of consolidated revenues. Within GBG, Retail and Small Business activity contributes 36% of consolidated revenues. GBG's Commercial activities generate a further 16% of revenues, which compares closely to the 17% derived from retail brokerage activity within Capital Management. CIB's Fixed Income Division generates 12% of revenues, mostly through its Structured Products group. The Wealth Management division contributes 5% of revenues.

The total net revenue described above ($30.0 billion) is net of the interest expense incurred and allocated to each business line. The total gross revenue generation (i.e. interest income plus noninterest income) by all product and service activities in 2006 was $47.0 billion. The sources of the corporation's gross revenue are shown in the figure, right.



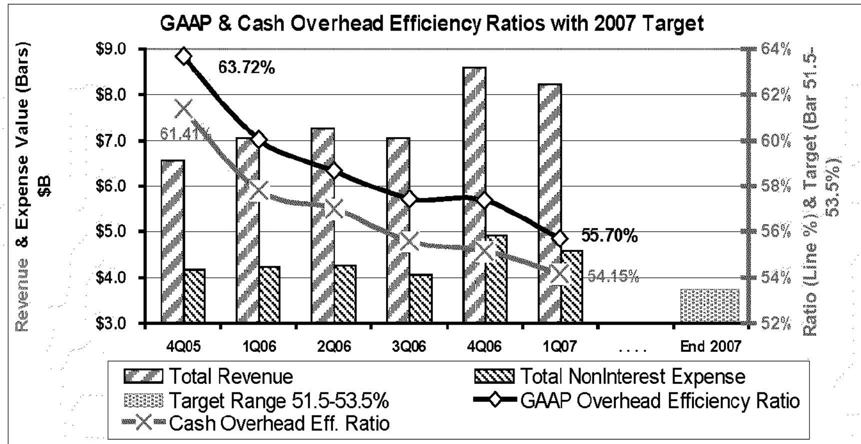
Wachovia now obtains some 49% of gross revenues from loan interest. In a change to previous years, the primary driver of interest income for 2006 was the expanded consumer RE portfolio, generating 19% of gross revenues. Commercial, financial and agricultural loan interest contributed 14%. Interest on securities represented 14% of annual receipts. (In contrast to the substantial growth in loans and total assets noted above, securities balances were actually reduced over the course of 2006 by 6%). One significant risk to earnings during 2006, was the difficulty in obtaining deposits. Prior to the injection of balances from the GoldenWest acquisition in October, deposits had declined over the first 9 months of the year. The loan to deposit ratio grew from 80% as of 12/31/05 to 103% at 03/31/07. The implication for Wachovia's liabilities has been the ongoing growth in long term debt, from a level of $49.0 billion at the end of 2005 to $142.3 billion as of 03/31/07. In the face of the continuing yield curve challenges, Wachovia's net interest margin contracted to 3.12% for 2006, from 3.24% for 2005 (and 3.41% in 2004). This annual achievement, however, obscures the downward trend on margins over the course of the year. The net interest margin achieved over the first quarter of 2007 was 3.01%.

A further risk to profitability is the return to long run levels of credit costs. The addition of WestCorp and the run-up of new credit card balances helped to drive up the provision charge for 2006 by 74% over its 2005 level. The ratio of net charge-offs to average loans for the first quarter 2007 was running at 0.15% (compared to 0.09% a year previous), and the ratio of nonperforming assets to loans was 0.40% (compared to 0.28% one year ago).

In contrast to the net interest margin, noninterest revenues demonstrated resilience over 2006. Although mortgage related fee income has been adversely impacted by recent trends, market based revenues, including asset management and investment banking, have been strong. The institution has achieved some success in transitioning revenue from brokerage transaction commissions to managed account fees.

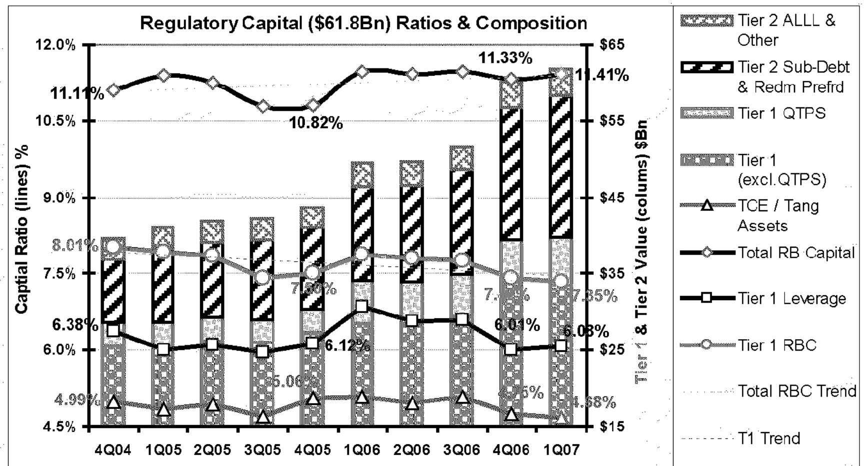
Wachovia is now two and a half years through its three year publicly declared initiative to drive down the rate of its expense growth. The intent has been to slow expense growth by an amount of $600 million to $1.0 billion by the end of 2007. The metric used to monitor expense restraint is the cash overhead efficiency ratio which excludes merger-related and restructuring expenses, other intangible amortization, discontinued operations, and changes in accounting principles. The corporations target range for the end of 2007 is 51.5 to 53.5%.

	Cash Overhead Efficiency Ratio		
	2007 Q1	2006 Q4	Target
GBG	43.98%	41.86%	
Wealth	70.22%	67.38%	
CIB	60.20%	55.16%	
CMG	72.07%	74.86%	
Corp.	**54.15%**	**55.17%**	**51.5-53.5%**



With the inclusion of the GoldenWest acquisition, the 2007 full-year net income is forecast to grow 18% to $9.4 billion, driven by a 14% expansion in revenue to $34.1 billion.

Although showing a greatly increased dependency on restricted-core and supplementary capital elements, Wachovia's capital position remains satisfactory.
Liquidity requirements, driven by acquisition activity and European expansion, have significantly raised long term debt levels in general, including subordinated issuance. As at 03/31/07, the tier 1 risk-based capital ratio, tier 1 leverage ratio and total risk-based capital ratios were 7.35%, 6.08% and 11.41% respectively. Shareholder equity was $69.8 billion; total regulatory capital was $61.8 billion; tier 1 capital was $39.8 billion, and tangible common equity was $31.3 billion. This compares to the first quarter 2007 average economic capital required of $24.3 billion, as calculated by Wachovia's internal economic capital model.



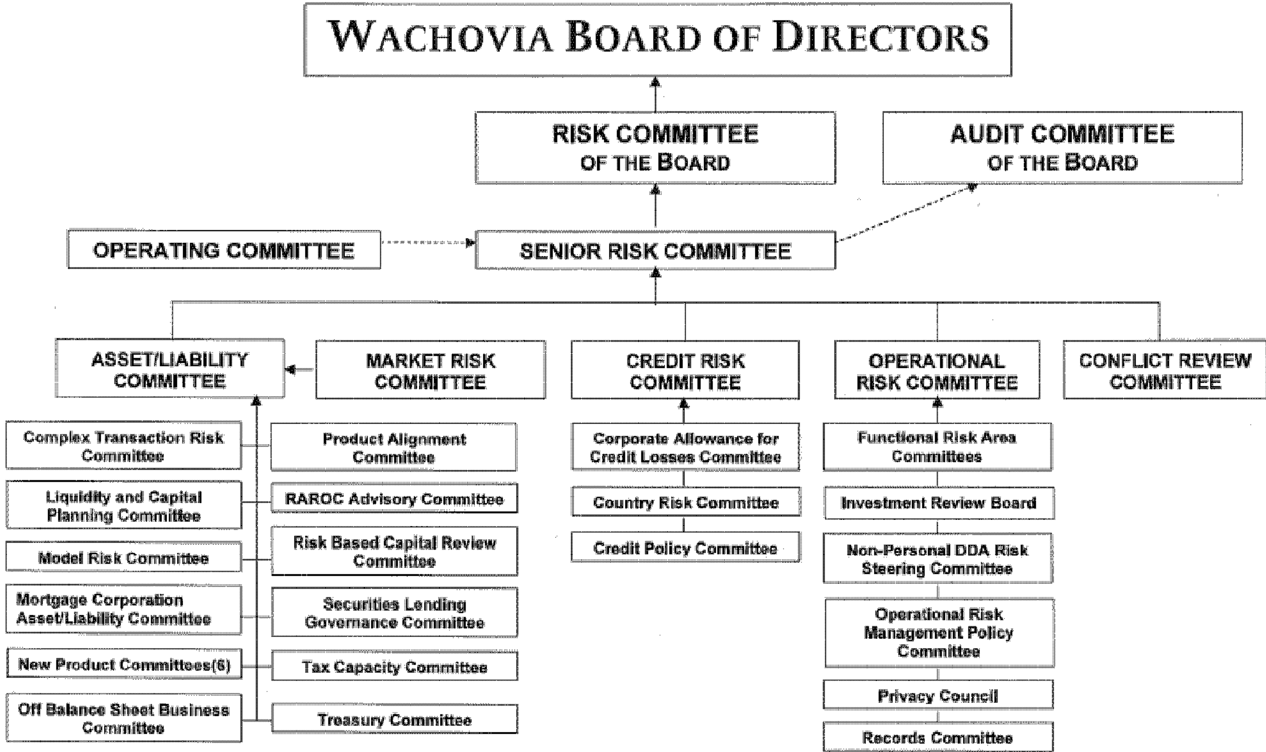
Corporate Governance

The **Board of Directors**, the members of which are listed below, is responsible for the oversight of the corporation's risk governance processes. Risk is managed through four main corporate groupings: the defined risk committee structures, an independent Risk Management function, an independent Internal Audit function, and within the operational business units.

G. Kennedy Thompson	Chairman, President & CEO of Wachovia Corporation
John D. Baker II	President & CEO, Florida Rock Industries, Inc., Jacksonville, Florida.
Robert J. Brown	Chairman & CEO, B&C Associates Inc. High Point, North Carolina.
Peter C. Browning	Director, Nucor Corporation, Charlotte, North Carolina.
John T. Casteen III	President, University of Virginia, Charlottesville, Virginia.
Jerry Gitt	Securities Analyst (retired), Palm Desert, California.
William H. Goodwin Jr.	Chairman, CCA Industries Inc. and Riverstone Group LLC, Richmond Virginia.
Maryellen C. Herringer	Attorney-at-Law, Piedmont, California.
Robert A. Ingram	Vice Chairman Pharmaceuticals, GlaxoSmithKline plc Research Triangle Park, NC.
Donald M. James	Chairman & CEO, Vulcan Materials Company, Birmingham, Alabama.
Mackey J. McDonald	Chairman & CEO, VF Corporation, Greensboro, North Carolina.
Joseph Neubauer	Chairman & CEO, ARAMARK Corporation, Philadelphia, Pennsylvania.
Timothy D. Proctor	General Counsel, Diageo Plc, London, England.
Ernest S. Rady	Chairman, California Banking Division, Wachovia Corporation.
Van L. Richey	President & CEO, American Cast Iron Pipe Company, Birmingham, Alabama.
Ruth G. Shaw	President & CEO, Duke Power Company, Duke Energy Corporation, Charlotte, NC.
Lanty L. Smith	Chairman, Soles Brower Smith & Co., Greensboro, North Carolina.
John C. Whitaker Jr.	Chairman & CEO, Inmar, Inc. Winston-Salem, North Carolina.
Dona Davis Young	Chairman, President & CEO, the Phoenix Companies Inc. Hartford, Connecticut.

(i) Committee Structures

On an annual basis the board approves a risk policy which delegates risk oversight to the **Risk Committee of the Board**. This committee, in turn, delegates to the **Senior Risk Committee of Management,** which is the governing body for five managing committees: **ALCO, Market Risk, Credit Risk, Operational Risk and Conflict Review**.



The **Risk Committee of the Board** consists of a minimum of three non-management directors and members of the committee are appointed by the board. The committee meets in conjunction with regularly scheduled board meetings on a bi-monthly basis. The committee receives information regarding the corporation's policies, procedures and practices relating to all categories of risk. The charter of the Risk Committee of the Board stipulates the information to be received from the Senior Risk Committee, the ALCO, and the Market, Credit and Operational Risk Committees. The **Audit Committee of the Board** is responsible for ensuring that all areas of the corporation have satisfactory internal controls that are operating effectively.

Under the corporation's risk governance policy, the **Operating Committee of Executive Management** is responsible for managing risks relating to business strategy, reputation risk and the general business activities of the corporation. The Operating Committee is composed of the most senior management of the institution, including all executives that report to the CEO. The committee meets on a monthly basis and receives MIS covering the financial results and metrics for the prior month. Projected income statements for the remaining quarters of the current year, full-year projected results, performance metrics and economic capital allocations are provided for every business line. The members of the Operating Committee are listed below:

Ken Thompson, Chairman, President & CEO	Tom Wurtz, CFO & Head of Finance
Ben Jenkins, Vice Chairman, President of the General Bank	David Carroll, President of Capital Management
Steve Cummings, Head of CIB	Ranjana Clark, Head of Marketing
Daniel J. Ludeman, President Wachovia Securities LLC	Benjamin F. Williams, Head of Global Capital Markets
Reginald E. Davis, Eastern Banking Group Executive	Cecelia S. Sutton, Head of Retail Segment, General Bank
Don Truslow, Chief Risk Officer, Head of Risk	Mark Treanor, General Counsel and Secretary
Gerald A. Enos, Head of Operations, Technology and eCommerce	Shannon McFayden, Head of HR & Corp. Relations

- The **Senior Risk Committee** is appointed by the Risk Committee of the Board. It is responsible for monitoring the direction of all types of risk relative to the corporation's business strategy. It also reviews emerging risks and monitors the steps taken to mitigate such risks. The committee meets monthly and consists of members of the Operating Committee. A key function of the committee is to consolidate perspectives across risk types and functional areas.
- The **Asset and Liability Committee** is tasked with the oversight of liquidity risk and interest rate sensitivity risk. The Chief Financial Officer reports directly to the CEO and is accountable for the management of these risks.
- The **Credit Risk, Market Risk** and **Operational Risk Committees** are appointed by the Senior Risk Committee and are responsible for the policies and limits associated with there respective risks.
- The **Conflict Review Committee** provides oversight of conflicts of interest that may arise across the institution. The committee provides a mechanism to address conflicts and a forum for resolution of cross business line conflicts.

(ii) The Risk Management Function

In conjunction with the formal committee reporting requirements, Wachovia additionally operates an independent **Risk Management** function with oversight of the corporation's risk appetite and approved risk limits. This corporate function monitors risk across the corporation and works with the business lines to establish and monitor the standards for risk taking. The Chief Risk Officer reports to the CEO and is responsible for the independent evaluation of credit, market and operational risk and for risk governance processes.

(iii) Audit

Wachovia's independent **Internal Audit** function reviews the entire corporation by dividing it into 373 identifiable audit entities, which are individually risk-assessed and prioritized. Some 37 high risk entities are audited every year, 209 medium risk entities are audited every two years, and 127 lower risk entities are reviewed once in every three years. By business line, the largest number of the 37 high risk entities reside in CIB (9) and IT (7). Wachovia operates some 300 internal audit staff, having grown the function aggressively since 2003. Turnover of staff is below industry average. Budgeted audit plan hours for 2007 total 488,000. During 2006, Internal Audit issued some 186 reports of which 151 returned a Satisfactory rating, 32 were rated Needs Improvement, and 3 were Unsatisfactory.

The corporation's **External Audit** function is conducted by KPMG, who meet with management on a regular basis to discuss current accounting and internal control issues.

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Legal Entity Structure

As of March 2007, the parent Wachovia Corp. held assets of $118.7 billion of which 87% were investments in subsidiaries and associated companies. Equity capital was $69.8 billion and the debt to equity leverage ratio was 55.7%. The double leverage ratio of equity investments in subsidiaries to equity stood at 132.4%. The schematic at the end of this section shows a representation of the main subsidiaries of the corporation.

(i) Bank Subsidiaries

As of March, 2006, Wachovia's consolidated assets stood at $706.4 billion. The assets of the national bank franchise, Wachovia Bank N.A. (WBNA) were $518.8 billion, equivalent to some 73% of consolidated assets. The table below shows the dominance of the bank on the corporation's interest-related earnings during 2006. (The GoldenWest acquisition did not occur until October). The CAMELS rating of WBNA is 2 / 222212.

	Wachovia 2006	WBNA 2006
Net Interest Income ($B)	15.4	14.1
Noninterest Income ($B)	14.5	9.6
Noninterest Expense ($B)	17.5	14.0
Provision ($B)	0.4	0.5
Net Income ($B)	7.8	6.4
Tier 1 Leverage Ratio (%)	6.01%	6.67%
Equity Capital ($B)	69.7	53.2
Loans ($B)	420.2	290.2
ALLL ($B)	3.4	3.0

Primary operating subsidiaries under WBNA include:

- Evergreen Investment Company, Inc., the Boston, MA, based investment management service. Evergreen is the asset management vehicle for the Wachovia's Capital Management and Wealth Management business lines described above.

- Wachovia International Banking Corp., an Edge corporation with assets of $3.7 billion, acts as the parent company for overseas activities conducted through the following main subsidiaries:-

  - Wachovia Securities International Ltd (WSIL), London, houses Wachovia's main European capital markets activities. WSIL serves two main functions: to market CIB investment products in the European arena and to conduct specific trading and distribution activities. During 2006, WSIL generated net income of $13 million. As of 12/31/06, the company held assets of $2.5 billion and equity capital of $281 million. WSIL is authorized and regulated by the Financial Services Authority in the UK and utilizes the Wachovia Securities trade name.

  - Wachovia Capital Finance Corporation (Canada), formally Congress Financial of Canada, conducts asset-based lending in Canada. As of 12/31/06, Congress Financial Corp. Canada had assets of $824 million and earned net income of $11 million during 2006 on revenues of $28 million.

- The Agreement corp., Cardinal International Leasing LLC, with assets as of 03/31/07 of $5.6 billion, holds the legacy First Union international banking operations. Cardinal earned $12 million in 2006. Cardinal International Leasing houses leveraged lease balances and was significantly impacted by the FAS 13-2 change in accounting standards. On 01/01/07, its equity capital was reduced by $928 million to $359 million.

- WBNA also owns the smaller Agreement corporations Monument Street International Funding I & II, of Roseville, CA, each with assets of $12 million and which own First International Advisors in London.

- Wachovia Card Services NA is the new 2007 credit card bank subsidiary of WBNA with assets of $1.3 billion.

In addition to WBNA, Wachovia additionally owns Wachovia Bank of Delaware, N.A., a $2.9 billion commercial bank based in Wilmington, DE., and Delaware Trust Company N.A., with assets of $397 million.

(ii) Nonbank Subsidiaries

In addition to these banks and their subsidiaries, Wachovia Corp. owns significant nonbank subsidiaries as described below:

- Everen Capital Corporation (assets as of $5.2 billion.) is the holding company for substantial nonbank activity conducted under the broadly used Wachovia Securities brand, primarily through Wachovia Securities LLC and Wachovia Capital Markets LLC. Wachovia Securities is the trade name for both the corporate and investment banking businesses of Wachovia (including Wachovia Capital Markets LLC and also the Edge Corp. subsidiary WSIL, described above) and also the retail brokerage businesses of Wachovia Securities LLC, Wachovia Securities Financial Networks LLC and First Clearing LLC.

  - Wachovia Securities LLC (WS) is registered as a broker-dealer with the Securities Exchange Commission and is a wholly owned subsidiary of Wachovia Securities Financial Holdings LLC (WSFH), which, in turn, is a majority owned consolidated subsidiary of Wachovia Corp. WSFH (with assets of $2.7 billion) serves as a holding company for the retail brokerage and clearing businesses contributed by Wachovia and Prudential Financial, Inc. and is based in Richmond, VA. As of 12/31/06, WS held assets of $3.9 billion, of which $1.0 billion was held as securities owned and $0.3 billion were securities purchased under agreement to resell.

  - WSFH's principal operating subsidiaries, other than WS, are First Clearing LLC and the broker network Wachovia Securities Financial Network, LLC. WS clears its brokerage transactions through First Clearing LLC.

  - Wachovia Capital Markets LLC (WCM) is the corporate and investment banking arm of the Wachovia Securities brand and is based in Charlotte, NC. At 12/31/06, Wachovia Capital Markets has assets of $20.9 billion, of which $10.7 billion are owned securities and $4.3 billion were securities purchased under agreement to resell. WCM is a registered broker dealer and possesses expertise particularly in the retail, defense, aerospace, utilities, financial services, health care, media and technology industries. As a vehicle for CIB activity, WCM provides advisory services, private capital, corporate lending and leasing, underwriting and trading services.

- Other CIB vehicles for investment banking activity include: Wachovia Capital Investments Inc., the home to legacy First Union investment banking operations (assets $1.5 billion); Wachovia Investors Inc. which is used to fund Wachovia's originated and acquired investments in funds and private equity (assets $2.0 billion), and developer Wachovia Development Corp, with assets of $1.0 billion.

- Insurance operations are conducted through the agency Wachovia Insurance Services, which now houses the activities acquired from Palmer and Cay.

- Union Hamilton Reinsurance houses Wachovia's reinsurance operations in Bermuda with assets of $3.5 billion. Wachovia additionally owns reinsurer Bluepoint Re, with assets of $406 million; also in Bermuda.

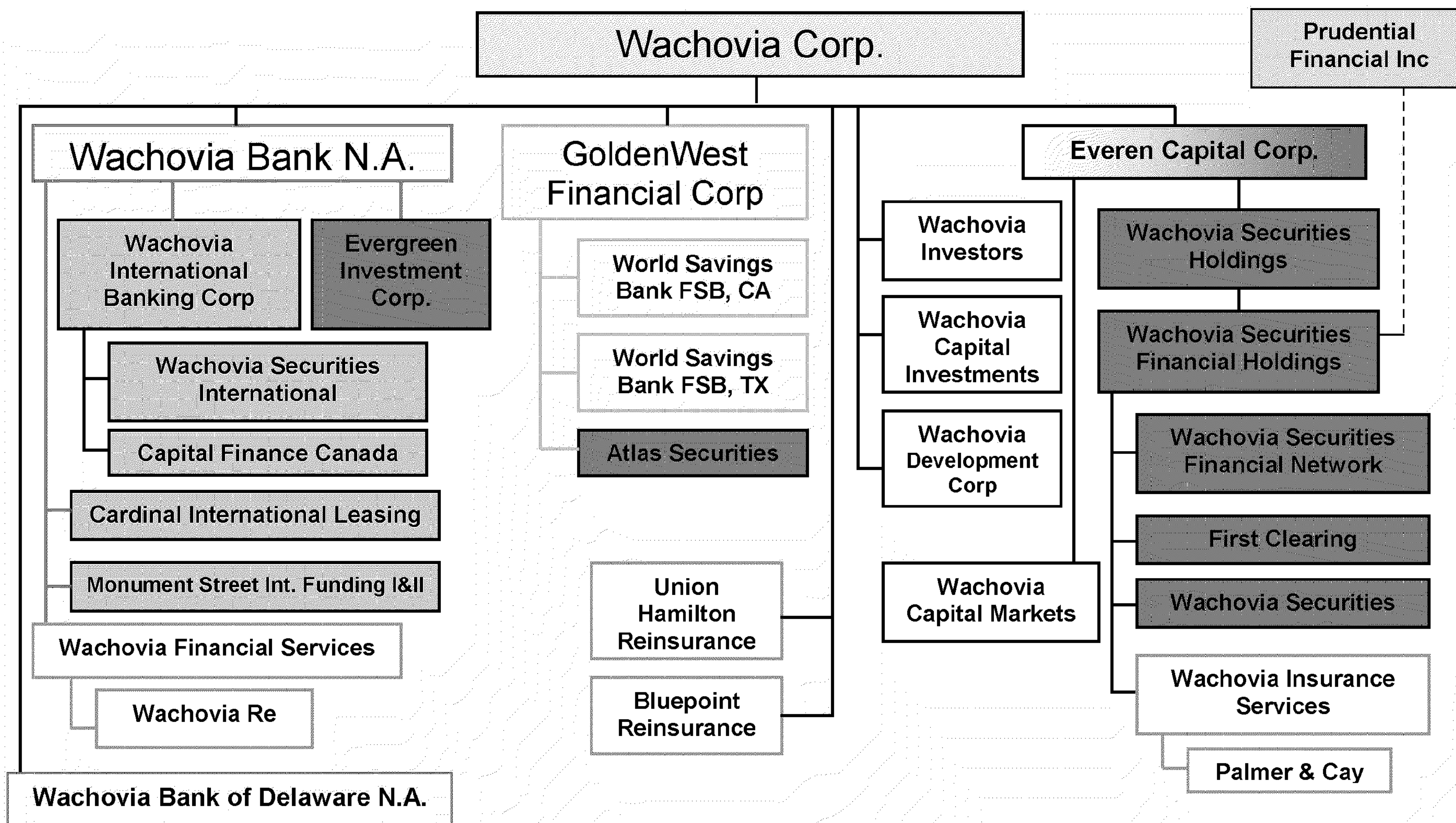
- In October 2006, Wachovia additionally acquired GoldenWest Financial Corp. (assets at 12/31/06 of $25.1 billion), which is the parent of two thrifts:

  - World Savings Bank FSB, Oakland CA, has assets as of 03/31/07 of $143.9 billion of which $113.5 billion are loans secured by first lien on 1-4 family dwellings.

  - World Savings Bank FSB, Houston TX, which as of 03/31/07 had assets of $15.9 billion, of which $14.3 was held as cash, deposits or investment securities.

  - GoldenWest Financial Corp. additionally owns the broker/dealer Atlas Securities LLC.

The graphic below shows the main subsidiaries within the Wachovia group.



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Regulatory Scheme

The FRB has lead responsibility for the regulatory oversight of the Wachovia Corporation financial holding company, the Edge and Agreement corporations and their international subsidiaries, and the non-bank subsidiaries of the holding company, excluding those which are functionally regulated by other federal and state supervisory agencies. In its role as the umbrella supervisor, the FRB also monitors these entities on an ongoing basis. The table below lists the supervisory coverage of the corporation and its significant subsidiaries.

Legal Entity	Institution Type	Agency	FRB Filing
Wachovia Corporation	Financial Holding Company	FRB	FRY9/Y9LP
Wachovia Bank NA	National Bank	OCC	Call
Wachovia International Banking Corp	Investment Edge Corporation	FRB	FR2886b
Wachovia Securities International Ltd	Foreign Subsidiary	FRB (FSA in UK)	FR2314
Capital Finance Canada	Foreign Subsidiary	FRB	FR2314
Cardinal Leasing International	Agreement Corporation	FRB	FR2886b
Monument Street Funding Intn. I & II	Agreement Corporations	FRB	FR2886b
Evergreen Investment Management Corp.	Investment Advisor	SEC	-
Wachovia Bank of Delaware NA	National Bank	OCC	Call
Everen Capital Corporation	Non-Bank Subsidiary	FRB	FRY11
Wachovia Capital Markets	Securities Broker Dealer	SEC	-
Wachovia Securities Holdings	Non-Bank Subsidiary	FRB	FRY11
Wachovia Securities Financial Holdings	Non-Bank Subsidiary	FRB	FRY11
Wachovia Securities LLC	Securities Broker Dealer	SEC	-
First Clearing LLC	Securities Broker Dealer	SEC	-
Wachovia Securities Financial Network	Securities Broker Dealer	SEC	-
Wachovia Capital Investments	Non-Bank Subsidiary	FRB	FRY11
Wachovia Investors	Non-Bank Subsidiary	FRB	FRY11
Wachovia Development Corporation	Non-Bank Subsidiary	FRB	FRY11
Bluepoint Reinsurance	Foreign Subsidiary	FRB	FR2314
Union Hamilton Reinsurance	Foreign Subsidiary	FRB	FR2314
Wachovia Insurance Services	Insurance Agency	States	-
GoldenWest Financial	Non-Bank Subsidiary	FRB	FRY11
World Savings Bank FSB, CA	Thrift	OTS	-
World Savings Bank FSB, TX	Thrift	OTS	-

As described in the previous section, the majority of Wachovia's assets reside in the national bank franchise, particularly those managed under the auspices of the GBG and CIB business lines. The Office of the Comptroller of the Currency (OCC) retains a resident team onsite at Wachovia to exercise authority under the national banking charter. The OCC staff is comprised of 40 examiners under 5 subject teams (Credit, Operations, Finance & Markets, Asset Management, and IT).

In addition to the FRB and OCC, the FDIC has a resident program with one individual assigned to Wachovia. Activities include preparing analyses on financial performance, attending meetings with the FRB and OCC, and participating in examination activity being conducted by the FRB and OCC.

The FRB monitors and conducts mandated annual reviews on the Edge and Agreement Corps. and their subsidiaries, which reside under the lead national bank. The most significant risks associated with Edge corporation activity lie with CIB's operations through WSIL, which is additionally regulated by the UK's Financial Services Authority (FSA). Other foreign regulatory bodies conduct visitations at other Wachovia business offices in Asia, Latin America, and Europe. To date, the resident Federal Reserve team has not interacted with other Foreign Regulators except with the FSA in the UK.

The FRB additionally conducts an annual risk assessment for non-bank subsidiaries. The ongoing monitoring efforts and targeted examinations associated with the CIB business line include the operations of investment banking entities and the wholesale broker dealer. Similarly, FRB conducts ongoing monitoring of the retail broker dealer activities of Wachovia Securities LLC and its affiliates within the Capital Management and Wealth Management business lines.

Securities and Exchange Commission (SEC) is the functional regulator for Wachovia Securities broker dealer operations and is responsible for supervising Wachovia's compliance with federal securities laws and regulations. In addition, the National Association of Securities Dealers (NASD) retains an interest in Wachovia's actions related to compliance with broker dealer guidelines and regulations.

Since the acquisition of GoldenWest in October 2006, regulatory oversight now additionally includes the auspices of the Office of Thrift Supervision. CPC staff have established ongoing communication with the responsible OTS team.

Wachovia's insurance activities also introduce the regulatory parameters of several state insurance commissions, which retain primary responsibility for interstate insurance sales and underwriting. Most of Wachovia's insurance businesses are agency-based, providing very little underwriting activity. As a result, and given the state commissions' limited resources, regulatory influence has been fairly limited. FRB resident examiners work closely with state agencies to ensure appropriate monitoring of risk management and sales programs.

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II. Risk Assessment Summary

Consolidated Executive Summary

Overall Summary Assessment of Inherent Risk

The inherent risk profile is considered moderate, which is unchanged from the previous assessment. Overall, Wachovia continues to benefit from a diversified business mix, large domestic geographic footprint, and management's measured risk appetite. The corporation is the fourth-largest financial holding company in the United States, with consolidated total assets of $706 billion. As noted in the I/O, the company has four main business lines that each offer a wide range of products that contribute to a diversified revenue base. While the assessment is unchanged from 2006, the risk profile of the company has shifted. The company has a much larger concentration of consumer mortgage-based assets with a negative amortization feature. Also, the GoldenWest purchase increased both inherent liquidity and interest rate risk as the funding mix was altered with increased FHLB borrowings. The A.G. Edwards purchase will increase strategic risk and will tax project management resources which are limited given the many key projects currently in process. The most recent annual RFI rating noted that elevated execution risk is a key issue facing the institution with both acquisitions and other legacy infrastructure projects. In addition, international operations are growing with the opening of an Irish Bank to expand the European lending platform to fund the growing CMBS business. This expansion is notable; however, Wachovia's international presence will remain much smaller than other larger bank holding companies. Other items influencing the risk profile of the company include above peer commercial real estate lending, an active bridge/leverage lending business, the complex trading activities related to the structured products business, and fair lending risk related to the nontraditional mortgage product.

Inherent Risk by Risk Type

Consolidated Inherent Risk Ratings	Inherent Risk by Risk Type													
	Credit Risk		Market Risk		Liquidity Risk			Operational Risk				Legal & Comp		
	Portfolio Characteristics	Portfolio Strategy	Banking Book	Trading Book	Market Access	Business Activities	Corporate Structure	People	Process	Systems	External Events	Cons / Com	Invest Banking	Wealth & Inv Banking
Factor Rating	Mod	Mod	Mod	Mod	Lim	Mod	Lim	Lim	Con	Con	Lim	Mod	Con	Mod
Overall Risk Type Rating	Moderate		Moderate		Moderate			Considerable				Moderate		

Credit

Wachovia's inherent credit risk profile is moderate. Traditional asset quality measures continue to be strong and compare favorably with historic norms and LFI peers. Overall credit risk benefits from higher quality obligors, strong collateralization levels, product and geographic diversity, and mitigation actions by management. In addition, like other LFIs, Wachovia continues to benefit from a generally positive economic environment. While the company has generally been considered a conservative lender, Wachovia has recently undertaken new revenue growth activities which have a higher risk return profile. Its March 2006 acquisition of WestCorp extended the corporation's presence within the auto lending and sub-prime markets. During the second quarter of 2006, Wachovia acquired American Property Financing, Inc., the leading agency multifamily lender in New York City. In the fourth quarter of 2006 Wachovia purchased GoldenWest, the second largest thrift in the US and historically a mono-line player in option-ARM products. GoldenWest is a full spectrum collateral-based lender with nearly 20% of the customer base having a FICO score below 620. Further international expansion is expected in 2007 with several new initiatives including establishing an Irish Bank to gain the passport authority into the European Union. This will allow the company to expand its commercial real estate originations platform and leverage its established CMBS business in Europe. These strategic moves coupled with the elevated level of commercial real estate exposure relative to LFI peers, the upward trend in notional/capital house limit exceptions, and the active leveraged/bridge lending business contribute to the moderate assessment.

Market (Trading Book)

Trading book market risk is moderate. Wachovia's trading activities are primarily conducted in the Global Markets Group (trading activities and underwriting securities) of CIB through four divisions: Global Rates, Structured Products, Credit Products, and Equity Products. As in past years, the level of risk as measured by VaR and non-VaR sensitivities is low relative to capital and the size of the institution. For 2006, only 16% of the Global Markets revenues were from trading P/L, with 60% resulting from fee based revenues. The fee revenue and relatively stable trading P/L is closely tied to Wachovia's investment banking philosophy to be a customer facilitation business and to exploit those markets where a high degree of customization is needed. As a result, the structured products division as well as structured rates, and equities products are the mainstay of Wachovia's trading business. Global Markets revenue increased from $3.4 billion in 2005 to $4.1 billion in 2006, almost entirely attributed to structured products. This specialization introduces other sources of risk warranting the "moderate" rating. The complexity of these products, the difficultly in pricing and hedging, trade booking difficulties, the limited customer base, accounting complications, and the associated warehousing of assets for impending securitizations all elevate the level of risk beyond what is evident from the VaR measures. Beyond the complexity, Wachovia finds its risk highly concentrated in the structured products businesses and in traded credit risk associated with financial institutions. The size of the warehouses, individual loans in the warehouses, and of the deal offerings are expected to increase in 2007. If these markets were to falter Wachovia would suffer moderate trading losses. But more importantly, its principal source of trading and fee revenues would be curtailed, as would the loan origination business which supplies the warehouses. Efforts to significantly expand into new product sets outside of structured products have not materialized. Geographic expansion is planned in Europe and Asia which will be predominately structured products and real estate lending. Credit products trading and equity products trading has scaled back volumes and scope of products significantly focusing on the core origination client base. Proprietary trading remains an insignificant risk.

Market (Banking Book)

Wachovia has a conservative interest rate risk philosophy but a growing inherent risk profile due to recent merger activity and a challenging rate environment. Management does not take significant views on the rate environment, preferring to maintain a relatively neutral risk posture. However, the addition of GoldenWest has added considerable mortgage exposure and presents hedging challenges due to the option-ARM product. This has raised the interest rate risk profile of the institution to moderate which is reflected in scenario analysis over the past year. Nevertheless, risk posed by the size and complexity of business activity is largely managed through strategic balance sheet decisions and the use of off-balance sheet derivatives.

Liquidity

Inherent liquidity risk is moderate based on the rating for balance sheet composition which increased due to a shift to greater wholesale funding. Wachovia continues to benefit from a positive reputation in both the market and retail deposit environment. Funding is primarily driven by a strong deposit base that has proven stable. Management attributes this loyalty to excellent customer service. Funding composition has shifted, though, due to GoldenWest and greater loan demand. Wholesale funding is now more prominent, but management is concentrating on diversifying market sources. Positive debt ratings and strong investor demand have afforded Wachovia favorable pricing. With loan growth projected to outpace deposit growth over the next year, management is forecasting debt issues to remain an important funding source. Besides domestic issuances, management has now initiated offering programs in Europe and Australia and is considering additional markets.

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Operational Risk

Inherent operational risk at the company is considerable. While some risk exposures, most notably information security, have stabilized to a degree, challenges remain. The assessment reflects the heightened execution risk exposure from the growing size and complexity of the company's operations and product offerings, coupled with its dependency on a technology environment that provides ongoing challenges. That said, over the past year the company has demonstrated satisfactory information technology (IT) production stability with only occasional issues noted. Additionally, there is adequate capacity to ensure daily production of all major processes and system response times have been strong. Disaster recovery testing conducted in the past year was successfully completed, and pandemic planning is progressing. To ensure ongoing improvement, various projects are underway to advance the efficiency of the underlying infrastructure.

While some lessening of the risk profile is noted, Wachovia does, however, continue to face challenges and some legacy operational risk issues remain a supervisory concern. The leading risk exposure is the proximity risk related to the company's two data centers in Winston-Salem, North Carolina. The new Oxmoor facility in Birmingham, Alabama was completed in June 2006. A three-to-four year plan is underway to move a significant portion of the production processing to that facility by late 2009. With one exception, risk remediation efforts aimed at addressing the long-standing CIS issues were generally complete at year-end 2006. However, while acknowledging the improvements in the control environment, work remains and the remedies are not yet seasoned and proven sustainable. Further complications stem from the technology environment which consists of a disparate portfolio of technology infrastructures, applications, and reporting systems. This situation is a product of years of mergers, acquisitions and wide-ranging business line technology deployments. While significant progress was made on some remediation issues, additional business line specific infrastructure improvements are still needed, such as the extensive technology infrastructure and applications simplification work that is part of a three-year project in CIB.

The company is continuing an aggressive offshoring/outsourcing program that will see FTEs grow from approximately 700 in December 2006 to nearly 2,100 by year end 2007 and management is looking for opportunities to offshore complete (end-to-end) business processes starting in 2008. Additional vendor reliance is being placed on a third-party service provider supporting the strategic growth initiatives in London. With the offshoring of applications and business processes comes delegation of critical controls to third-parties domiciled in foreign sovereignties. Finally, although Wachovia is not a key player in the critical payments markets, the increasing volume and nature of transactions adds complexity as the company's presence in the national payments system becomes increasingly prominent.

Legal and Compliance

Overall, inherent risk at Wachovia is moderate which is changed from the considerable rating it had in 2006. The inherent risk guidance and the recalibration of the associated ratings are the primary reasons for the change rather than a substantial shift in their risk profile. Wachovia continues as the 4th largest domestic bank with limited international presence. The consumer and commercial bank presents moderate risk with the only change in the profile coming from the GoldenWest acquisition. The GoldenWest acquisition does add significant volumes of non-traditional mortgages to their suite of products and the underwriting process employed does increase their fair lending risk profile although it is diminished by the lack of risk based pricing. Sub-prime activities continue to be limited to their indirect auto lending business and credit card activities are not significant. The investment banking risk profile is considerable primarily driven by the BSA/AML risk associated with their correspondent banking business with leading market share in Latin America and Asia. Wealth and Investment management is moderate given the significant size of their broker/dealer Wachovia Securities, LLC. this is the third largest in the US. They do not have significant private banking activities and their mutual fund company is only in the top 20. Their business activities similar to the consumer and commercial bank are limited internationally with only brokerage activities in Latin America and asset management in London with no plans to significantly expand any of these.

Overall Summary Assessment of Risk Management

Overall risk management practices for Wachovia Corporation are considered satisfactory. The assessment is based on management's actions to address the key risks facing the institution and the effectiveness of controls and oversight across the company. During 2006 management continued to make sound progress on a number of critical initiatives to improve the risk management and control environment of the firm. This included improving the infrastructure of CIB and increasing the staffing in the market risk management function. The company has devoted appropriate resources to the proximity risk issue and has developed a comprehensive plan for the Oxmoor data center. The audit department remains satisfactory and the change from General Auditor Schild to former Controller Julian is viewed as a positive step toward increasing the stature of internal audit. Also, the performance of the compliance risk management function has been adequate and the department is well positioned to monitor the risk associated with new acquisitions and business expansion.

Despite the noted improvements, management continues to face significant challenges going forward with the multitude of critical infrastructure projects underway. Concerns remain with management's ability to execute on key projects as certain initiatives have been delayed, redesigned, cancelled, and/or suffered cost overruns. These concerns have been expressed to senior management of the company. In our annual RFI assessment to the company, project management and execution risk were the main thrust of our message to the company. Management has taken steps to address this concern by developing various control processes including an investment review board that closely monitors key projects. In addition to the project management issues, the company continues to address legacy issues including the key IT remediation projects. With one exception, risk remediation efforts aimed at addressing the long-standing CIS issues were generally complete at year-end 2006. However, while acknowledging the improvements in the control environment, work remains and the remedies are not yet seasoned and proven sustainable. The customer information security (CIS) project is not complete, which drives the "fair" rating for overall operational internal controls.

Risk Management and Controls

Consolidated Risk Management and Controls Summary	Risk Management and Controls																							
	Board and Senior Management Oversight						Policies & Procedures						MIS and Risk Monitoring						Internal Controls and Audits					
	Cre	MRTB	MRBB	Liq	OpR	L/C	Cre	MRTB	MRBB	Liq	OpR	L/C	Cre	MRTB	MRBB	Liq	OpR	L/C	Cre	MRTB	MRBB	Liq	OpR	L/C
Subcomponent Ratings by Risk	Sat	Sat	Sat	Str	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Fr	Sat
Overall Rating	Satisfactory						Satisfactory						Satisfactory						Satisfactory					

Board and Senior Management Oversight

Board and senior management oversight is satisfactory. The rating continues to reflect active Board oversight with adequate interaction evidenced in the company's business activities, risk management, and compliance practices. A recent review of board packages and minutes indicates that key issues and potential future risk items are discussed in detail with the directorate. Receiving particular attention is the CIB business line as senior management is insuring that the directors have a complete understanding of the risk profile of this complex business line. In 2006, there were some changes to the senior management team with CFO Wurtz and CIO Enos replacing seasoned leaders in the company. The management team effectively transitioned these key players into new roles with minimal impact to the corporation. CEO Thompson and his executive management team continue to provide capable, experienced leadership while also demonstrating a solid understanding of the risks facing the company. The Board committee structure effectively completed its oversight duties as evidenced by the work of the Risk Committee and Audit Committee. Senior level discussions were noted around emerging risks and industry issues in key senior management committees including the Senior Risk Committee, the Operating Committee, the Credit Risk Policy Committee, and ALCO. The business line leadership governance structure ensures ownership and accountability for risks and appropriately rewards risk mitigation practices. Enterprise-wide risk management is sufficiently aligned with key business lines. Appropriate attention continues to be centered on key risks including long standing IT/Operational risk weaknesses, strategic investment decisions, strengthening BSA compliance across all parts of the company, and reviewing new/complex product offerings.

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Policies, Procedures and Limits

Policies and procedures across the financial institution are considered satisfactory. The company has established a conservative limit structure for credit, trading exposures, interest rate risk, and liquidity. In some areas, however, the updating of corporate policies has not kept pace with the business activity of the company. Throughout 2006, there were a significant number of relationships and some industry exceptions to the current credit capital guideline structure. Management is aware of the issues surrounding the credit capital limit exemptions and new guidelines have been approved. Other limits have been adjusted including the corporate Value-at-Risk (VaR) trading limit which was adjusted to deduct Treasury positions, thus giving more head room for future warehouse risk with the European expansion. Treasury positions are taken generally to hedge balance sheet positions and the deduction from the corporate VaR limit appears appropriate.

Risk Monitoring and Management Information Systems

The institution's risk monitoring and management information systems (MIS) are satisfactory. Wachovia continues to demonstrate effective risk management oversight given the risk profile of the company. During 2006, our compliance monitoring and testing examination noted a satisfactory monitoring program while recommending consistent usage of the issues tracking database and the formalization of the issues escalation procedures. Firm-wide stress scenario analysis is still evolving. Risk reporting for interest rate, market, and liquidity risk includes stress scenarios but specific credit event stress tests are only completed on an ad-hoc basis. While the current practice may be appropriate, additional credit stress testing is going to be completed with the real estate exposures in the GoldenWest book. Operational risk metrics continue to evolve as management develops methodologies for quantifying top-of-the-house metrics.

Internal Controls

Corporate-wide internal controls are satisfactory but long-standing weaknesses with IT/Operational control remain. The assessment notes throughout the document that the control environment is improving as reflected in the results of internal audits, external reviews, and regulatory examinations. While data center risk has also been a longstanding concern, we are pleased with the company's progress on the issues and the plans to utilize the third data center in Birmingham as a meaningful backup resource. Other control functions, including business line risk management and compliance, demonstrate a solid understanding of the risks facing the company. Internal audit remains satisfactory and it appears the selection of former Controller Julian to replace retiring General Auditor Schild is viewed positively. Credit review continues to demonstrate its stature as an independent control function which helps reinforce the risk tolerance of the company. Credit risk portfolio hedging continues to be proactive by implementing measured credit risk mitigation activities.

Credit

Credit risk management is satisfactory. Board and senior management oversight is effectively conducted through various executive credit committees. Wachovia has a well-developed credit approval process and maintains up-to-date, comprehensive credit policies online that clearly communicate risk parameters. Current systems and management reporting are adequate for traditional credit management purposes. While requiring manual intervention, full exposure levels for names are available in a reasonable time frame. Wachovia has recognized the need for improvement in its MIS, given its increase in size as well as the increase in the array and complexity of its product offerings. Additional focus is being placed on data aggregation and concentration management with Risk Data Strategy (RDS), a high profile project to enhance data accuracy and reporting capabilities. While this project is currently in Red status (due primarily to the problems with the Data Integration Workstream), Wachovia remains confident that RDS is viable. Wachovia has also started its transition to a less judgmental risk rating system with the rollout of Generation 1 Scorecards covering approximately 60% of the commercial portfolio. Credit Review and Internal Audit functions provide effective independent review of credit exposures and processes. Wachovia has done a satisfactory job of mitigating the risk of its current portfolio, in the past primarily through loan sales and securitizations and CDS protection on single name exposure. In addition, Wachovia now has implemented a Macro Event Risk Hedge Program to provide event risk protection and some level of systematic risk mitigation.

Market (Trading Book)

Market risk management and controls remain satisfactory and have improved since the previous assessment, continuing the trend noted in the 2006 RAP. Our assessment is based on ongoing supervision report reviews, discussions with management, joint examinations with the OCC covering Structured Products, Equity trading, and Market Risk Management. Five internal audits have been conducted since mid-year 2006 that pertain to trading activities. These were all rated satisfactory. Most Matters Requiring Attention from the Regulators and Internal Audit have been addressed. The completion of staff hiring, installation of a new VaR calculator, and rewrite of many policies has kept to timelines proposed by management. Many of the new Market Risk Management staff are from outside of Wachovia and bring a new level of sophistication and trading experience to the company. Production errors associated with VaR calculation and position reporting have been greatly reduced. Trader mandates have been completed for all trading desks except for structured products. Automated position reconciliations are now conducted and additional stress tests have been added. Daily desk level risk reporting is now available for all desks and includes limit usage information and a full complement of risk sensitivities. A P/L attribution gap analysis has been conducted and a rudimentary report is now produced. Finally, the model validation function has developed a sound policy, a template for the validation documentation, and has reduced its backlog of non-validated models. New products continue to be added to the VaR specific risk model and equity specific risk model is currently under review by regulators

Market (Banking Book)

Interest Rate Risk management practices are satisfactory. The most prominent change over the last year is the successful implementation of BancWare for Earnings-at-Risk. Economic Value of Equity implementation is scheduled for Summer/Fall of 2007, but does not face the same limitations of RADAR that the Earnings-at-Risk model faced. BancWare has eliminated the manual system workarounds present as part of RADAR and has improved production capabilities. Management is now working on a dashboard that will help identify trends and key drivers of risk. The GoldenWest loan portfolio does present modeling issues. Consequently, it is modeled on the legacy GoldenWest model, BankMaster, and added to BancWare's production.

Liquidity

Risk management practices are satisfactory. A strong and experienced management team has developed comprehensive policies and reports to aid in governance of the liquidity function. Improvement to processes and reporting continue, especially through the Enterprise Funding Initiative (EFI). The EFI remains a prominent program to centralize liquidity oversight. Wachovia is an outlier in the use of hard dollar limits, but addresses this concern directly in the policy. Quarterly contingency funding analysis is comprehensive, now including the parent company, and sufficiently stresses funding access with alternative funding sources identified.

Operational Risk

Overall, operational risk management practices are considered satisfactory, and management is generally receptive to remediation of issues identified by audit or regulators; however, certain significant timeframes for exposure remediation have prolonged the heightened risk environment. Operational risk management practices are a combination of direct business or function oversight and support from corporate functions and validation from audit. While current practices are satisfactory, as evidenced by a lack of material single event losses or operational breakdowns, strategic growth initiatives have the potential to tax the infrastructure if it does not keep pace with the changing environment. Overall audit continues to show improvement and is rated as a satisfactory risk and control function, but regulatory concerns remain with respect to IT audit and the Audit Project Office.

Internal controls are generally considered satisfactory and it is clear that business and functional management own the risk and responsibility for implementing a satisfactory control environment. That said, a lack of final, and proven sustainable resolution to the information security remediation programs result in an overall fair rating for controls. Outside of these issues, senior management of the company has demonstrated a commitment to address weaknesses in the control environment, as evidenced by improving percentages of satisfactory audits and a reduction in the days outstanding for issue resolution. Moreover, management continues to strengthen technology governance practices and

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these enhancements are beginning to mature, but full effectiveness and sustainability have yet to be achieved.

Legal and Compliance

Risk management at Wachovia is satisfactory which is unchanged from 2006. There have not been any significant changes to the risk management practices at Wachovia nor has there been any exam (OCC, SEC, NYSE, NASD, and FED) or internal audit results that have shown any major deficiencies. The OCC has rated the quality of risk management as satisfactory for compliance and BSA/AML. Two areas of concern are with CCO Bill Langley's retirement and the compliance efficiency initiative which will be occurring simultaneously. CCO Langley is expected to retire at the end of August/September while the efficiency initiative is expected to begin implementation in late 4th quarter/1st quarter. The compliance efficiency initiative is a project sponsored by CCO Langley and authorized by Chief Risk Officer Truslow to ensure they have the most efficient and effective compliance model as well as to reduce the expected 2008 compliance budget by 15-25% ($15-25 million as compliance budget is expected to be $100 million). Senior management has made it clear they have no appetite to increase their risk profile and it is not expected to result in significant compliance staff layoffs. This is only proposed and has not been finalized so there could be changes in the above proposed structure.

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III. Detailed RAP Documentation

Credit Risk

Inherent Risk

Inherent Credit Risk Ratings	Inherent Risk: Credit Risk – Portfolio Characteristcs											Portfolio Strategy	
	Portfolio Quality	Loss Predictability	Maturity of Credit Business / Product	Exposures to Specialized Business Lines	Market Liquidity of Credit Risk Exposures	Use of Credit Risk Mitigants	Portfolio Seasoning	Lumpiness	Credit Risk Concentration	Groth in Volume / Profitability	Market Leader / Follower	Growth Goals and Potential Sources of New Loans	New Products, Business Lines, or Clients
Subfactor Rating	Lim	Lim	Mod	Mod	Lim	Mod	Mod	Lim	Mod	Mod	Mod	Mod	Mod
Factor Rating	Mod											Mod	

<u>PORTFOLIO CHARACTERISTICS:</u> ***<u>Moderate</u>***

PORTFOLIO QUALITY: ***Limited***

The portfolio mix has historically been more commercial than retail (58% commercial/42% retail at YE 2005), but Wachovia's recent acquisition of GoldenWest Financial changed that mix. Consumer loans/total loans increased to 60% at YE2006, further shifting the balance sheet into higher yielding assets. In the meantime, traditional asset quality indicators do not reflect increased inherent risk, due not only to their lagging nature but also to their measure of residual vs. inherent risk. The Bank's more extensive use of credit management techniques has helped to keep residual risk in check. Looking at portfolio quality from a number of angles shows that current portfolio quality poses limited risk.

The loan portfolio is broadly diversified by industry and geography. Additionally, the portfolio is well collateralized:

- 79 percent of the commercial loan portfolio is secured by collateral
- 99 percent of the consumer loan portfolio is secured by collateral or guaranteed.

Of the consumer real-estate-secured loan portfolio:

- 87 percent is secured by a first lien
- 83 percent has a loan-to-value ratio of 80 percent or less
- 95 percent has a loan-to-value ratio of 90 percent or less

Portfolio distribution by credit rating is strong. On the retail side, while Wachovia has stated their intention to go out further on the risk/reward curve by dealing with customers with lower FICO scores, their FICO scores, refreshed quarterly remain very high. In CIB, Wachovia continues to target both investment grade & leveraged borrowers. Investment grade debt is the larger part of the mix at 79%, with leverage loans (rated 5 and 6) remaining stable at 19% and criticized assets declining from 5% to 2%.

Traditional credit risk measures are still at very favorable levels after years of steady improvement. Asset quality numbers compare positively to LFI peers, admittedly aided by high collateralization and Wachovia past lack of a credit card portfolio. Strategic improvements in loan portfolio management have had a beneficial effect on portfolio risk as well. Loans outstanding as of March 31, 2007 totaled $421.7 billion, $167.1 billion commercial and $254.6 billion consumer. Net charge-offs as a percentage of average net loans were .12% in 2006, up slightly from 2005. The increase was primarily due to higher than normal charge offs for the WestCorp portfolio and the reducing level of recoveries in the commercial portfolio. Management provided an initial 2007 charge-off guidance range to the market of 0.10% - 0.25%, with an internal projection of 0.15% for the full year. Management does not see any events that should change the current stable environment for at least another 6 months. The low level of net charge-offs also reflects a continuing robust credit environment and the highly collateralized nature of Wachovia's portfolio as well as

the careful management of the inherent credit risk in the loan portfolio. The addition of GoldenWest also reduced the annual charge-off percentage. GoldenWest has a long record of extremely low net charge-offs, including none for the past eight years, reflecting their strong underwriting and credit risk management.

Nonperforming assets (including AHFS and foreclosed property) were 0.23% at 4Q06, compared to 0.40% at 4Q05. Asset sales help drive down the NPA and criticized levels during the 4Q06. Nonperforming levels are projected to remain relatively stable during 2007.

Through the cycle (TTC) expected loss for the commercial portfolio has declined from 0.50% in May 2003 to 0.19% currently. Consumer TTC expected loss increased to .35% as a result of the addition of WestCorp and, to a more limited extent, the addition of a credit card portfolio. This is a normal increase for the risk/return profile of the consumer portfolio. These levels are both well below management's benchmark level of 0.40%. The ALLL as a percentage of loans at the national bank remains adequate at 1.10%.

Recognizing that the economic capital process is highly judgmental and assumption-driven, the cushion between the level of economic capital and tangible common equity (TCE), does give, nonetheless, some broad indication of the Bank's view of the sufficiency of capital to support the level of expected losses for different types of risk. Wachovia's cushion would seem to indicate sufficient capital to support the level of credit exposure as credit risk capital ($15.8 billion) is primarily attributed to wholesale and retail exposures and represented 65% of economic capital (after diversification), which is well under 65% of TCE of $31.3 billion ($20.4billion).

(see also CREDIT CAPITAL under CREDIT RISK MANAGEMENT AND CONTROLS.)

LOSS PREDICTABILITY: ***Limited***

Expected losses for their existing portfolio are generally predictable. Internal risk ratings are mapped to PDs and LGDs. Since Wachovia in 2006 began the process of transitioning to a less judgmental rating system that utilizes scorecards, it has not been tested for accuracy in a down cycle. The commercial portfolio is weighted toward investment grade credits. This makes the accuracy of predicting default and loss rates in this portfolio less complicated than it would be otherwise. Wachovia's KMV weighted average EDF was 25bp at March 31, 2007. Its median EDF at 4 bps compared with KMV's overall population's median EDF of 39 bps.

While the consumer portfolio historically has been more traditional/predictable, the proliferation of new mortgage products (primarily option ARMs) and the reported overvaluation of real estate in certain regions provides a challenge for predicting losses in that portfolio. That being said, until the acquisition of GoldenWest, the volume of new mortgage product business was not large. In addition, GoldenWest's historical credit track record has been strong, with peak losses at a low 18bps in 1994 (following a meaningful downturn in California real estate). GoldenWest's losses have averaged essentially 0 bps since 1998 (versus 13 bps on average for the industry). The credit card portfolio is still small with outstandings less than $2 billion. Since Wachovia's credit card strategy has been to market to existing customers, its credit card portfolio boasts an average FICO score of 740.

Even with its acquisitions and re-entry into the credit card business, current full year 2007 charge-off projections are .16% with external guidance in the mid-teens. As stated earlier, the first quarter charge-offs ratio was 15%.

MATURITY OF CREDIT BUSINESS / PRODUCTS: ***Moderate***

While the majority of its business resides in mature, stable markets and products, Wachovia has started offering, prompted by competition, some new liberal first mortgage products as well as interest-only home equity loans. In addition, it has recently entered some product areas, such as sub-prime auto lending, credit card direct issuance, and Option ARMs that are new to Wachovia. Mitigating some of this new product risk is acquired knowledge through its acquisition of WestCorp that specializes in sub-prime lending or keeping in place (as in the case of GoldenWest) senior management that has experience with the new products. In addition, with its credit card portfolio, the business strategy has been to market to existing customers, by definition keeping FICO scores high.

EXPOSURE TO SPECIALIZED BUSINESS LINES: ***Moderate***

While Wachovia's portfolio is predominantly traditional commercial and consumer credit products, there are some

specialized products on their books, such as asset-based lending (ABL), Commercial Real Estate (CRE), Leveraged lending, and Option ARMs. The total volume of these specialized products merits a moderate rating for Wachovia.

Wachovia's asset-based lending business (legacy Congress Financial and legacy Wachovia ABL), have been joined under the name Wachovia Capital Finance (WCF). At 12/31/06, ABL outstandings for WCF totaled $5.5 billion under total ABL commitments of $14.3 billion. The unit also manages an additional $1.6 billion in ABL outstandings that are actually booked in the General Bank, but have been referred to WCF because of their ABL expertise. The combined total of $7.1 billion is probably the most accurate representation of total ABL outstandings, but the distinction should be noted. The OCC conducted a WCF Exam in 2006 and rated the entity Satisfactory with sound portfolio quality and prudent underwriting.

WCF has as its goal to be the preferred provider of financial solutions for businesses utilizing asset-based lending within the Wachovia franchise states and the national turnaround and corporate ABL market. Target market generally includes prospects that will provide strong, long-term lending relationships for Wachovia and/or capital markets opportunities. WCF will generally not finance sub-prime commercial paper, construction companies, emerging and high-tech companies, startup situations, conflict of interest situations or borrowers involved in significant, serious litigation.

CRE is another specialized product for Wachovia and is highly sensitive to national macroeconomic factors as well changes in local and regional economies. As of March 31, 2007, CRE exposure was $72.2 billion and represented 22.6% of both Total Exposure and Total Commercial Economic Capital. Wachovia targets national and regional developers among its income property clients and generally focuses its CRE lending in markets within its geographic footprint as defined by the location of its retail banking offices, but will deviate from this to follow existing clients into new markets.. Source of repayment for income properties is generally expected to be permanent refinancing, although Wachovia may finance the properties using its own balance sheet. REFS relationship managers often assist clients in obtaining permanent financing, which may be accomplished by arranging private placements or via CREF's conduit. Source of repayment is well diversified given the broad geographic footprint and variety of regional and local economies.

While Wachovia's large and growing exposure to residential builders is a concern, a 2006 OCC target review concluded that appropriate controls are in place over this product. The bank is very cognizant of the potential impact of deterioration in the CRE portfolio given the concentration. The bank also has a large CRE warehouse but this area continues to perform well as the bank continues to show the ability to securitize these assets. Management has a strategic initiative to expand the CRE structured product platform into the European market in 2007. This should not add significant credit risk but both we and the OCC will monitor.

Given CRE's distinct credit characteristics in terms of probability of default, loss given default, CRE decided a series of credit grading scorecards would be appropriate. Segmentation includes the sectors/product types: income property, office retail, multifamily, industrial, land, A&D, AD&C, condominiums, multifamily, builder lines of credit, residential, and borrowing base lines.

CRE's credit quality statistics are satisfactory. Charge-off experience has been favorable and improving over the past few years with net charge-offs amounting to 8bps in 2002, 2 bps in 2003 and less than 1 bp in 2004-Jun 05 and -.01% in 2006. Other credit quality statistics for the overall portfolio as of 12/31/06, compared to goal:

	Actual	2006 Goal
Criticized	1.27 %	2.00%
Classified	.39 %	1.00%
Past Dues	.24 %	0.25%
NPAs	.13 %	0.30%

Wachovia's Credit Risk Review (CRR) has recently noted weaknesses with small builders, but noted that the larger builders thus far have been able to weather the downturn. While SNC review is continuing, downgrading of some CRE exposure is occurring, primarily from Special Mention to Substandard. We will continue to closely monitor this exposure.

Leveraged lending is another specialized lending area for Wachovia. Wachovia has been an active player in this market

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both as an originator and facilitator. For 2006, Wachovia ranked 5th in leverage loan originations and number 12th in high yield bond originations. As of March 12, 2007, the exposure to leveraged loans was approximately $15.6 billion. In the trading book, the inventory of high yield bonds/CDS net long was $100 million.

Wachovia's Leverage Finance business includes:

Leverage bank loans
Bridge lending
High yield bond underwriting
High Yield sales and trading (bonds and CDS)
Par Loan sales and trading

Wachovia defines leveraged lending when all of the following are true:

- The purpose of the transaction is to finance an acquisition, decapitalization, recapitalization or dividend, or to refinance an existing leveraged loan
- Total loan exposure to the borrower is $5 million or more;
- The Borrower Default Grade is 5.5 or worse; and
- The value of the collateral securing the loan, properly margined per policy, covers less than 75% of the committed loan amount and reliable guaranties are not in place to cover the remaining amount.

The structured products group also has exposure to leverage loans in the form of CLO warehouses, secondary trading in CLO's, CLO equity tranche investments, and total return swap (TRS) transactions on leveraged loans. These exposures are under $1 billion. Wachovia does not have a distressed debt trading platform at this time, but has plans to expand into this business in 2007.

High yield bridge commitments are short-term underwritings to borrowers with agency ratings lower than Baa3/BBB-. These bridges are underwritten with the anticipation of a high yield takeout by a bond or equity offering. Wachovia's Bridge limit was recently increased to $5.0 billion.

Revenue from leveraged finance in 2006 was $363 million of which $297 million was from origination activity, predominately loans, and $66 million was from trading activity. Loan trading volume in 2006 was up 47% over the previous year with an increase of 65% in the number of trades. The average hold amount for 2006 was 13% and Wachovia been successful in placing most deals to the target hold amount with only 3 deals having "overhold" amounts for 2006.

Shock P/L loss for bridge loans and bank loans is limited to $300 million or $200 million if the commitment is beyond 90 days. Management noted that Flex provisions of 50bp on bank loans and roughly 200bp bridge caps cover the majority of modeled market corrections. The market shock scenarios represent the impact of a large deterioration in credit spreads. For Bridge loans the shock is .50% spread widening across all ratings. For Bank loans it is .75% widening for BB and B rated positions and 1.50% for CCC. For Bonds and mezzanine debt the shock is 1.75% for BB, 2.75% for B, and 6.00% for CCC. (This level of spread deterioration has been observed two or three times in the last 15 years.) This shock attempts to capture potential losses the bank may need to take to syndicate the exposures. These market shocks are offset by fees for a net P&L after market shock amount. Management limits this number to a $400 million loss for committed and mandated deals. The bank can go over this limit but would need to hedge the exposure. The bank as of 5/28/2007 was at a $293 million potential loss after market shock.)

Limits for HY sales and trading are low and usage under the limits is low. The limits are detailed and include issuer risk by name and rating category, but not by industry. Top 10 long and short names by spread and notional are reported daily. The majority of CR01 risk is in the BB, B, and CCC buckets.

Exposures for leverage finance loans are subject to approval by the Leveraged Loan Committee. Credit Risk monitors the weekly loan distribution report for slow moving deals and overholds. Leveraged lending policy is documented. Leveraged debt is sold to an array of institutional investors including banks, insurance companies, pension funds, and hedge funds. An important internal customer of the Leveraged Finance business is the CLO/CDO warehouse of the

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Wachovia Structured Products business.

Option ARMs are another type of specialized lending that Wachovia does. Option ARMs are housed primarily in GoldenWest and represent the largest block of specialized lending. At the time of acquisition, the GoldenWest portfolio was approximately $125 billion and consisted almost exclusively of Pick-a-Payment Option ARMs. GoldenWest reputation is for historically conservative underwriting with average loan balance < $240,000, average LTVs of 68%, 10-year reset period to reduce risk of payment shock, underwritten to fully indexed rate, diligent documentation standards and in-house appraisers.
The following are features of the GoldenWest Pick-a-Payment loan:

- Thirty year, monthly adjusting, variable rate mortgage secured by a first lien
  - Accrual rate based on monthly-moving index rate plus a fixed margin
  - Payment options: Fully amortizing; 15-year fully amortizing; interest-only; minimum payment
- Minimum payment = established fixed monthly amount for one year; represents fully amortizing payment based on lower than market interest rate; resets annually with 7.5% increase on prior year's payment
  - Permits negative amortization up to 125% of the original loan amount on loans with originated LTV ≤ 85%; or up to 110% for loans with original LTV > 85%
- Loans "recast" after 10 years or when loans reach caps of 125% or 110%
  - Resets to amortize principal and interest over remaining life of the loan or borrower refinances
- Loans generally have a maximum interest rate cap over the life of the loan

In January 2007, members of the Wachovia team met in California with GoldenWest (and senior Wachovia personnel) and their primary regulator, the OTS. We have also met the member of Wachovia's Internal Audit team leader (a former GoldenWest auditor) covering GoldenWest. The OTS will begin their annual exam of GoldenWest in June. We will continue our discussions with them as the exam progresses.

Other than sub-prime auto financing through WestCorp (reflected below under Wachovia Dealer Services), Wachovia does not offer a sub-prime product. Wachovia has reported that the part of their portfolio they consider sub-prime (FICO scores <620, excluding no scores) is as follows:

Wachovia (excluding WDS and GW)	2%
Wachovia Dealer Services	26%
GoldenWest	20%
Total Wachovia	13%

Helping to mitigating this risk is the experience that WestCorp has with sub-prime auto financing and the underwriting and other control measures that GoldenWest has around their Option ARM product.

MARKET LIQUIDITY OF CREDIT RISK EXPOSURES: ***Limited***

Most credit risk exposure on Wachovia's books has liquid secondary markets and the company has made a concerted effort to implement an "originate to distribute" philosophy. Several areas keep track of deals done in the market to make sure that Wachovia has institutional market knowledge and that its new deals are priced and structured so as to make them marketable. An example of this would be the weekly reports produced for the leveraged loan area, giving a market update, detailing weekly statistics on volume, pricing trends. A similar report is also produced on the investment grade loan market. Market conditions are discussed as a regular agenda item at meetings of various credit committees.

USE OF CREDIT RISK MITIGANTS: ***Moderate***

Credit mitigation activity at WB continues to grow in both volume and sophistication. WB makes use of credit mitigants at both the line of business level and at the corporate credit risk management level. Public Portfolio Management purchased an additional $149MM single name LCDS during March 2007, including $119MM of less

liquid names in a bulk trade with Morgan Stanley. To date they have purchased $474MM protection in LCDS and expect to continue growing this number past the $500MM mark which was their prior target (no new target has been set). PuPM is currently in the process of buying protection on 41 names, $250MM notional in a transaction with Citibank and is considering using one confirmation with an exhibit listing the names as opposed to 41 individual confirmations. Notionals range from $3-10MM per name; with names falling in a variety of industries. The most represented industries are Business Equipment & Services (19% by notional) and Broadcasting (14% by notional).

Wachovia has also implemented a Macro Event Risk Hedge Program to provide event risk protection and some level of systematic risk mitigation. As of April 18, 2007, the program consisted of $10.75 billion in corporate CDS indexes (CDX) and $250 million of protection in CMBS CDS indexes (CMBX). After the CRC and ALCO meetings in early March, the decision was made to increase the CDX program by the equivalent of $5 billion notional. Actual notionals are slightly lower than $12 billion (original 7 plus incremental 5) due to a reallocation of the equivalent carry into lower rated (higher spread) indexes

(See also CREDIT RISK MITIGATION and PORTFOLIO MANAGEMENT AND REPORTING.)

PORTFOLIO SEASONING: ***Moderate***

While most of Wachovia's portfolios are mature, they are expanding their product offering. Some of the products are new to Wachovia (such as sub-prime lending, Option ARMs and re-entry into credit card issuance. Others, like some of the newer mortgage and home equity products, are new to the market. They pose additional risk as their performance has not been tested in an economic downturn. Even with the newer products, Wachovia has tended to be conservative in their adoption. 60% of the market's home equity lending is variable rate while only 30% of Wachovia's home equity lending is at variable rates. While variable rate home equity suggests less interest rate risk to banks, it also suggests more credit risk. If that is so, Wachovia's credit risk arising from their home equity product may be less than that of some of their competitors.

LUMPINESS: ***Limited***

House Limits are designed to protect Wachovia from lumpiness in the portfolio by establishing limits for maximum notional loan exposure and maximum pre-settlement risk exposure to any customer relationship, based on its WA FDG. Credit risk economic capital-based triggers for a customer relationship have also been established. Transactional risk exposure is not subject to House Limits, but is governed by authority delegation.

House limits are established for CIB and Congress Financial separate from those for the GBG, Wealth Management and Parent segments. In addition, separate house limits have been established for asset securitizations and emerging market banks. All extensions of credit are subject to the house limits of the appropriate line of business. Credit decisions by Special Assets Management or the Special Situations Group pursuant to a workout of criticized assets are exempt from the house limit approval requirements.

House limits are conservative. For example, within CIB, the notional loan limits range from $600 million for a transaction with a weighted average FDG of 1.5 to $50 million for a FDG of 6.2, $35 million for a 6.5 ($50 million for Congress), $25 million for a 6.8 and $10 million for 7.2 and worse ($50 million for Congress). The credit risk economic capital trigger for CIB is $4 million. GBG, Wealth Management Group and parent house limits are even lower: ranging from a notional loan limit of $400 million for a 1.5 FDG to $50 million for a 5.8, $35 million for a 6.2, $25 million for 6.5, and $10 million for a 6.8 or worse. Their credit risk economic capital trigger is only $2.5 million for this group.

In addition, CDS hedges help to reduce booked excess. The March 2007 Credit Risk Portfolio Committee package showed 484 pass grade relationships with excesses after CDS Hedge. (It should be noted, however, that 321 were GBG relationships where the exposure guidelines are only $2.5 million.) The Weighted Average (WA) Facility Default Grade (FDG) of these excesses was 4.8 with the WA LGD of 4 (25%) and WA Tenor of 5.7 years. .

CREDIT RISK CONCENTRATION: ***Moderate***

Concentration guidelines protect Wachovia from excessive credit exposures to any single industry or real estate product

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type and facilitate the diversification of risk. Portfolio guidelines are to be considered in the development and execution of all business plans and in the management of the portfolio. Guidelines have been established based both on notional Loan Exposure and Credit Risk Economic Capital (which includes economic capital for both Loan Exposure and Pre-settlement Risk Exposure) and are measured against 61 industry segments and 10 real estate product groups.

Exposure is managed with the goal that notional Loan Exposure and Credit Risk Economic Capital within an industry segment or real estate product type will be less than 3% of total wholesale notional Loan Exposure and Credit Risk Economic Capital, respectively.

Whenever a segment exceeds 5% of Credit Risk Economic Capital, a plan is developed to reduce Credit Risk Economic Capital below 5%, or an exception is to be explicitly approved. (Note: the capital action guideline for both Non-residential Real Estate and Public Administration is set at 7.5%) If Definition Real Estate exposure exceeds 20% of Credit Risk Economic Capital, a plan is developed to reduce Credit Risk Economic Capital below 20% or an exception must be explicitly approved.

For the month of March 2007,five industries were over the 3% *Capital watch* guideline. These were Other Retail Trade, Office Buildings, Condo/Single Family, Non-Defined RE, and Non-residential Real Estate. The number of industries over the 3% *Exposure* guideline was 9. These included Non-depository Institutions, Other Retail Trade, Individuals, Non-residential Real Estate, Health Services, Condo/Single Family, Depository Institutions, Public Administration and Non-defined RE.

Real Estate remained over the 20% capital guideline at 22.6% of commercial EC and of commercial exposure. Although CRE represents a concentration, within this concentration careful customer selection has helped to provide diversity by region and product type. Florida at 21.3% as the end of 3Q06 represents the largest geographic concentration. Single-family homes represent the single largest REFS collateral/purpose concentration, with 17% of total commitments, followed by condominiums at 11%, retail at 10%, apartments at 10% and office at 9%. Product mix in concentrated in construction lines of credit and mini-perm term loans.

While the acquisition of GoldenWest boosted Wachovia's residential real estate exposure to 24% of revenue (versus 7% stand alone), Wachovia's risk is in line with peers given Wachovia's average LTVs on home equity is among the lowest in the industry, its FICO scores are above average and 70% of home equity is in first lien (versus 30% for the industry).

GROWTH IN VOLUME / PROFITABILITY: ***Moderate***

Wachovia's outlook for 2007 computes growth rates from an illustrative combined Wachovia and GoldenWest as if the two companies had merged on January 1,2006 and before merger-related and restructuring expenses. Loan growth is projected in the the high single-digit percentage range from $398.4 billion. This includes consumer loan growth in the low double-digits percentage range from $249.6 billion and commercial loan growth in the mid single-digit percentage range from $148.8 billion. Net interest income growth is projected in the low single-digit percentage range on a tax-equivalent basis compared with $18.1 billion. This growth is projected to be organic rather than from new acquisitions.

MARKET LEADER OR FOLLOWER: ***Moderate***

Wachovia is more often a market follower in terms of product introduction, but tends to be in the top provider segment for many of its products. For instance, Wachovia is the #1 middle market lender in its footprint and the #1 US CMBS loans contributor and master servicer. In other areas, Wachovia is:

- No. 5 in leverage loan originations
- No. 12 in high yield bond originations.
- No. 1 bank mortgage lender
- Top 3 US asset-based lending lead

PORTFOLIO STRATEGY: ***Moderate***

GROWTH GOALS AND POTENTIAL SOURCES OF NEW LOANS: ***Moderate***
GROWTH OUTSIDE THE CURRENT MARKET: ***Moderate***
NEW PRODUCTS, BUSINESS LINES OR CLIENTS: ***Moderate***

In 2006, average net loans grew 35% to $308 billion. This increase included average consumer loan growth of 67%, driven by the addition of GoldenWest and of WestCorp, and the transfer of $12.5 billion of home equity lines to the loan portfolio from loans held for sale at YE2005 . Excluding these effects, average consumer loans increased 8 percent, reflecting increased consumer real estate secured activity. In addition, loans reflected organic growth in middle-market commercial and commercial real estate construction lending, large corporate lending and international lending.

As noted above (See GROWTH IN VOLUME AND PROFITABILITY section above), loan growth is projected in the the high single-digit percentage range from $398.4 billion with consumer loan growth in the low double-digits percentage and commercial loan growth in the mid single-digit percentage This growth is expected to be organic. Recent acquisitions have given Wachovia the opportunity to expand its geographic footprint, branch network, and product offerings, Wachovia intends to capitalize on its broad product array with expanded branch network, credit card and mortgage offerings as well as auto dealer services.

Further international expansion is likely in 2007. Wachovia is expanding their international presence with several new initiatives including (1) establishing an Irish Bank so that they can have passport authority into the European Union; (2) applying for a Singapore Branch under a wholesale bank license; (3) exploring opportunities for WSIL type activities throughout Asia; (4) establishing an entity in Korea for lending activities; (5) establishing a real estate capital markets entity in Europe and Asia; and (6) studying the feasibility of a Canadian branch. The Irish bank application was filed in October 2006. Irish authorities and the Fed have recently asked Wachovia to respond to questions that they have about the application and consequently this application is still pending.

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Credit Risk Management and Controls

Credit Risk Management and Controls	Risk Management and Controls																					
	Board and Senior Management Oversight				Policies & Procedures				MIS and Risk Monitoring									Internal Controls and Audits				
	Board Governance Structure & Oversight	Management Governance & Oversight	Ownership Relationship-Risk-Portfolio roles	New Products-Services Approval Process	Credit Risk Policies & Procedures	Limits	Approved exceptions to policy-tolerance	Credit Underwriting	Credit Info Tech Systems	CR Rating System	Ongoing Credit Analysis	Portfolio Management & Reporting	Counterparty Credit & Settlement RM	Credit Risk Mitigation	Problem Loan Management	Credit Capital	Third Party Tools & Services	Credit Administration	Loan Security Interests & Collateral Mgmt	Loan Review/Credit Audit	Model Review & Validation	Loan Loss Reserve Process
Individual Factor Ratings	Sat	Sat	Sat	Str	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Fr	Sat	Str	Sat	Sat	Sat	Sat	Sat	Sat	Sat
Overall Rating	Sat				Sat				Sat									Sat				

BOARD OF DIRECTOR AND SENIOR MANAGEMENT OVERSIGHT: *Satisfactory*

BOARD GOVERNANCE, STRUCTURE AND OVERSIGHT: *Satisfactory*

The Board of Directors (BOD) provides a satisfactory level and quality of oversight to the Bank's activities. The BOD is responsible for delegating and annually reconfirming the authority of the CEO to approve credit up to the legal lending limit of each Wachovia bank. The CEO is empowered to further delegate this lending authority. Only an authorized officer with sufficient delegated credit approval authority for the level of risk contemplated is permitted to incur credit risk. Approval authorities are tiered relative to an officer's position in the hierarchy, with junior officers having lower approval authority, which may require higher-level concurrence to commit to particular exposure levels. The corporate credit policy establishes house exception limits and concentration policies to manage concentration risk.

The Senior Risk Committee (SRC) is appointed by the Board of Directors to approve and implement the risk governance structure for the company, monitor the direction of risks relative to business strategies and market conditions, identify emerging risk and direct actions to mitigate those risks as it deems appropriate, incorporating the mitigation efforts into the strategic planning process.

While the Board receives information that is timely and sufficient to understand credit risk exposure, it is less comprehensive than a strong rating would require.

SENIOR MANAGEMENT GOVERNANCE, STRUCTURE AND OVERSIGHT: *Satisfactory*

Senior Management governance, structure and oversight is Satisfactory. Senior management has staffing levels sufficient to measure, monitor and report risk exposures to the BOD. Wachovia has shown a solid ability to plan for credit risks arising from dynamic business conditions and maintains a mostly effective credit-audit program that has shown dramatic improvement over the last few years.

Management continues to take appropriate action to address supervisory credit concerns, with the Senior Risk Committee (SRC) providing proper oversight of the formal remediation processes for any supervisory concerns. environment for its credit risk.

OWNERSHIP RELATIONSHIP /RISK/ PORTFOLIO MANAGEMENT ROLES: *Satisfactory*

Wachovia's risk management strategy is aligned around four components of risk governance, each with a specific role:

- Business units are responsible for identifying acknowledging quantifying mitigating and managing all risk

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- Independent risk management function (joined by other corporate staff functions such as legal) provides objective oversight of risk-taking activities and translates overall risk appetite into approved limits. Credit Risk Review reports administratively within Risk Management but directly to a committee of the Board.
- Internal Audit, which reports directly to the Audit Committee of the Board of Directors, provides an objective assessment of the design and execution of Wachovia's internal control system and risk committees
- Risk committees provide a mechanism to bring together the many perspectives of the management team to discuss emerging risk issues, monitor risk taking activities and evaluate specific transactions and exposures. All risk committees ultimately report to the Senior Risk Committee. The Senior Risk Committee directly oversees the activities of the Credit Risk Committee, along with the other four key management committees, Market Risk, Operational Risk, Asset and Liability, and Conflicts of Interests.

NEW PRODUCT APPROVAL: *Strong*

Wachovia has a corporate policy addressing New Products. The policy provides for the creation and operation of a New Product Committee in each of the five major business segments. Any new products, or changes in existing products that would materially alter their risks, require the approval of the New Product Committee. These committees are responsible for thoroughly examining the associated risks. New Products committees are required to report on their activities at least quarterly to the ALCO Committee, which is responsible for reviewing and approving, prior to implementation, any new product or any material change to existing products that could have a significant impact on the corporation's liquidity, capital, market risk, or pricing.

POLICIES, PROCEDURES AND LIMITS*: Satisfactory*

POLICIES AND PROCEDURES: *Satisfactory*

This rating is changed from *Strong* last year to *Satisfactory*. The rating change is due to the number of acquisitions in 2006 including WestCorp, Amnet and GoldenWest. Management is in the process of standardizing slight inconsistencies between legacy Wachovia units which are transitioning/merging with the new units. We would anticipate a return to the *Strong* rating by the end of 2007.

Lending policies are consistent with Wachovia's overall strategic direction and tolerance limits. The Risk Committee of Wachovia's directorate review and the Senior Risk Committee review and approve the broad credit risk governance for the bank. The Risk Committee annually reviews major changes to credit policy. The Credit Policy Committee reviews and approves new policies and changes originated by the Corporate Risk Policy Department or by business units engaged in credit activities. The Corporate Risk Policy Department is responsible for determining which policies are presented for approval to the Credit Policy Committee. The Credit Risk Committee approves certain high-level enterprise policies.

Policies are easily accessible by lending staff on the Wachovia intranet system, Risk Policy Online (RPO) contains all applicable lending policies. Recent revisions are also readily available on the RPO application. House limits are based on notional amounts and economic capital that is driven by risk rating. Infractions are reported at the top of the house.

The Credit Risk Policy notes that the institution's risk appetite may vary over time as conditions change, and it lists certain underlying tenets that are intended to remain fundamentally stable:

- They are cash flow lenders.
- Each transaction (unless cash secured) has two sources of repayment.
- Extensions of credit based on projections that are inconsistent with past performance are considered only on a highly selective basis.
- Underwriting focuses on risk identification, mitigation and appropriate reward.
- They manage concentration risk through house limits and concentration policies.
- Every member of the relationship team has responsibility for ensuring that risk taken is not excessive.
- There is no appetite for credits with a likelihood of cash flow deterioration, except in certain specialized lending units.

LIMITS: *Satisfactory*

To achieve the minimum desired diversification for their credit portfolio, Wachovia has established House Limits for maximum notional Loan Exposure and maximum Pre-Settlement Risk Exposure to any customer relationship based on

its Weighted Average Facility Default Grade. Credit Risk Economic Capital-based triggers (which include both Loan and Pre-settlement Exposure) for a customer relationship have also been established. Transaction Risk Exposure (TRE) is not subject to House Limits, but is governed by authority delegations.

Limits are established separately for Corporate and Investment Banking and Capital Management from those for the General Banking Group, Wealth Management and Parent segments. In addition, separate House Limits have been established for Asset Securitizations and Emerging Market Banks. All extensions of credit are subject to the House Limits of the appropriate line of business.

In addition to approving the maximum credit exposure to individual commercial borrowers or related group of borrowers, the Credit Risk Committee approves limits as well as for industry concentration and country exposure limits. Compliance with limits is reviewed monthly as part of Credit Risk committee meetings.

UPDATE:

On June 18, 2007, the Wachovia House Limits Project released the results of its review of House Limits. Changes in policy are:
1) Aggregation of exposures: The policy for aggregating exposures into a single relationship for house limit purposes has been revised, with additional guidance on the de-coupling of exposures. The request for de-coupling exposures that demonstrate both economic independence and independent sources of repayment should be initiated by the LOB and approved by the LOB Credit Risk Officer (with notification to the LOB Head).
2) Single Name House Limits: The revised house limit framework differentiates limit grids by credit quality and the presence of secondary market liquidity, whereas the previous limits were differentiated by Credit Quality and LOB. Notional and EC Limits for liquid credits are "shaved" by 25% for illiquid credits on the amounts. The highest notional limit is 900 vs. 600 previously.

The derivation of new limit amounts is a product of an in-depth analysis of several key research areas, including composition of current excess, forensic loss analysis, Credit Portfolio Managers (IACPM)Survey, syndications market demands, peer bank limits and WB & Peer growth. Such analysis was augmented by input from SMEs in Wachovia LOBs and Risk Management.
3) Strategy for Managing Excess: To maintain tolerance within new limits the following strategy has been proposed
- Operationally, excess exposures are aggregated for the entire corporation
- A tax rate----differentiated by IG and non-IG- is assigned to the aggregate excess
- The tax amount is allocated to each LOB based on its contribution to the total tax amount
- The tax amount is conveyed to the LOB through Treasury's monthly FTP process. To provide flexibility related to single name portfolio management within the LOBs, a moderate cushion beyond the proposed limits has been incorporated into the framework.
- To allow forward planning, including budget considerations, a glide-in period is proposed. This will also allow the development of implementation systems and processes. The cushion begins at 5% in 4Q2007 and is reduced to 1% by 4Q2008. The first tax due in this scenario would be 2Q2008.

APPROVED EXCEPTIONS TO POLICY /TOLERANCE: ***Satisfactory***

Aggregated exposure to any customer relationship which exceeds the House Limit for the Notional Loan Exposure amount, the Pre-Settlement Risk (PSR) amount, or the Credit Risk Economic Capital amount must be documented as a House Limit Exception and approved by the Chief Risk Officer or designee and, if required, senior Line of Business manager. This exception approval process must be repeated whenever the exposure increases. New exceptions to House Limits and trend data are reported to the Credit Risk Committee quarterly and to the Risk Committee at least semi-annually.

While the processes are Satisfactory, there is an increasing level of commercial house limit exceptions. Part of that is driven by the increased role that Wachovia is playing in the syndications market for investment grade credits that requires their taking larger initial positions. Another driver is the modest level of limits in place, e.g., the notional loan exposure limit for CIB is $600 million for FDG 1.5 and for GBG is $400 million. Their credit risk economic capital trigger is only $2.5 million for GBG and $4MM for CIB.

CREDIT UNDERWRITING: ***Satisfactory***

Wachovia has had to respond to the increasing competition and liquidity in the syndicated market. The result has been more deals underwritten with higher total leverage and/or heavily back-ended repayment programs. They have tried to mitigate this risk by limiting hold levels. As part of the SNC program, the OCC is collecting certain information on any new credit, M&A credit, or recapitalization credit underwritten in2006. The results of that will be reviewed and discussed with Wachovia. Middle market and commercial real estate lending standard are also under pressure. Credit Risk Review continues to note stretching and underwriting exceptions for stronger borrowers. While we and the OCC have seen some slippage, the OCC target reviews concluded that underwriting is satisfactory. On the retail side, much of the underwriting is automated. Models and policies are incorporated into computer programs or "decisioning engines". Once the retail loan is extended, it is included in the overall portfolio, which is continuously monitored for changes in delinquency trends and other asset quality indicators. The currently high FICO scores have been discussed earlier, as has the possible impact of the bank expanding its credit universe, testing lower FICO scores to maintain growth, the addition of sub-prime lending through its acquisition of WestCorp, and its re-entry into the credit card issuer business.

Various systems such as CATools, Portal, Application Handler) document and place controls over the underwriting process. Reviews by the OCC have found these systems satisfactory.

CREDIT APPROVAL: ***Strong***

The Bank has a very good credit culture which is embodied in its processes. Credit risk is managed through a combination of policies and procedures and authorities that are tracked and regularly updated in a centralized database. The Board of Directors grants credit authority to the CEO, who in turn, has delegated that authority to the Chief Risk Officer. Credit authorities are further delegated through the independent risk management organization.

There are two processes for approving credit risk exposures, both of which are "owned" by risk management who is segregated from the production process and engaged in underwriting, credit approval and servicing activities.

The first involves standard approval structures (such as rapid decision scorecards) for use in retail, certain small business lending and most trading activities. Custom scores combined with FICO scores drive the decision process, with overlays for DTI and credit bureau derogatories. There are loan amount and LTV matrices based on custom score. Approval hierarchies for loan amount, overrides and other exceptions are in place and imbedded in underwriting system.

The second approach involves individual approval of commercial exposures. Since credit approval authorities are "tiered", larger and riskier exposures require a greater level of authority, which brings the necessary experience and discipline to the process.
Consumer credit approval authority is recorded and tracked in the Application Handling (AH) system.
Commercial credit approval authority is used to underwrite, approve and manage the risk in a given exposure to a commercial customer or relationship as detailed in the exposure and house limits policies. No credit exposure may be incurred, no commitment issued, nor existing exposure renewed or modified, until approval from an individual with the appropriate type and level of authority has been obtained. In addition to the types of authority, transactions subject to certain policies require further approval, e.g., Reg O policy, the house limits policy and product-specific policies such as types of definition real estate or underwritten syndicated loans.

Authority is based on the Facility Default Grade (FDG), only for transaction for which the individual has responsibility, and approvers must have authority for the transaction on a standalone basis as well as authority for the aggregated exposure and weighted average FDG.

<u>RISK MONITORING AND MANAGEMENT INFORMATION SYSTEMS: *Satisfactory*</u>

CREDIT INFORMATION TECHNOLOGY SYSTEMS: ***Satisfactory***

Wachovia has in place adequate credit IT systems for traditional credit management purposes. While requiring manual intervention, full exposure levels for obligors are available to senior management in a reasonable time frame. MIS to credit risk committees includes credit quality metrics, loan syndication and credit mitigation information, large and

excess exposure reports, along with market information.

With its products increasing in array and complexity, Wachovia recognizes that it needs to make improvements to its MIS. Wachovia is designing and implementing a strategic risk information management environment (RIME) that will be delivered by the Risk Data Strategy project (RDS). The first phase of the strategy will focus on credit risk information to prepare Wachovia for compliance with Basel II. Ultimately, the risk information environment will encompass credit, market, operational and interest rate risk data and will provide more accurate and consistent data for management decision-making across the company. RIME includes a new data warehouse and associated technologies and business processes. The new environment will provide efficient comprehensive storage and analysis of massive quantities of data while improving the ability to trace and reconcile information. Data will be consistently defined and will aggregate across business lines.

RIME will:

- Satisfy near-term data needs for Basel II compliance
- Bring together all retail and commercial credit risk data into a single repository and will equip end-users with the tools and support to easily access all this information
- Provide the majority of data required to enable a view of the full customer relationship across the company
- Position Wachovia to achieve better risk management practices as well as enhanced customer service, target marketing and cross-selling opportunities

RDS project moved from yellow (at risk) status to red due to continued issues transferring data. This project remains the single most challenging project and slippage is seriously jeopardizing other projects and future MIS improvements. Management can use exiting fragmented data marts if RDS issues continue We, along with the OCC, will continue to monitor progress on this critical project..

CREDIT RISK RATING SYSTEM: ***Satisfactory***

The Grading Systems Committee is a subcommittee that reports to the Credit Policy Committee and ensures that grading systems throughout the corporation are equitable and produce default rates and loss given default rates that are in line with historical results. The primary purpose of the grades is to assist in the evaluation of risk and pricing, the management of individual facilities and relationships, as well as the portfolio as a whole. There are three different grades: the borrower default grade that measures the relative strength of the legal entity borrower; the FDG that measures the expected default frequency of the subject facility; and the LGD grade that measures the average amount of loss over a given economic cycle that can be expected if the facility defaults.

Last year we anticipated to you Wachovia's transition to more transparent, less subjective grading process, utilizing scorecards to improve consistency and grading accuracy. Ernst & Young worked with Wachovia in the development of their new scorecard system.

Generation 1 to the new scorecards included scorecards for core C&I, CRE and individuals and was rolled out September 2006 and is projected to cover 60% of the portfolio. C&I included a scorecard for core public and private industries as well as special scorecards for Broadcasting, Healthcare, Power/Utilities-regulated and Retail type services. CRE scorecards were designed for income producing (Multifamily, Retail, Office and Industrial), SF Residential (Land, Acquisition and Development, Acquisition, Development and Construction, Builder Lines and Borrowing Base) and condominiums. Scorecards for individuals were broken down into Non-CRE (High Net Worth and Generic) and REFS.

Generation 2 includes scorecards for additional segments (Asset Securitization-seller servicers, Dealer Financial Services, Financial Institutions, Not-for-profit hospitals , Municipals, Not-for-Profits, Higher Education, Religious organizations, professional practices, Sovereigns) as will as segmentations to Gen 1 scorecards (Healthcare, Hospitality, and Multi-asset entities under CRE Income Producing; Land under CRE Residential; and International Corporates and Small Business under C&I.)

The Facility Grade Worksheet has been automated for segments where the scorecard has been implemented. Other segments continue to use the Facility Worksheet. The Facility Grade Worksheet allows for calculation of both the FDG

and the LGD Grade. The FDG calculation is relatively objective and will often be the same as the Borrower Default Grade but need to take into consideration any Liquid Collateral/Letter of Credit or Strong Guaranty/Third Party Support. The LGD grade is established by independently and objectively assessing the average percentage of loss that could be expected if the facility were to go to non-accrual. The calculation consists of aggregating point values from collateral, guaranty/third party support and the original Borrower Default Grade. All commercial borrowers require a Borrower Default Grade and all facilities require a FDG and a LGD grade. The appropriate Borrower Default Grade Worksheet and Facility Grade Worksheet are required for all borrowers/facilities to document the grading process.

The OCC's supervisory plan includes a series of Risk Rating Replication Reviews designed to help determine if Wachovia's new risk rating system, driven by scorecards, has adequate controls on the accuracy of inputs, conformance with policy and controls on override practices. We plan to participate in those for CIB and CRE.

ONGOING CREDIT ANALYSIS: ***Satisfactory***

Each credit relationship managed within the GBG Commercial, business banking or community banking segments or within the Wealth Management Group is serviced in CATools and must have a defined servicing plan. The goal of servicing is to confirm that the sources of repayment remain viable, that the key risks identified are relevant and that grades are accurate. The frequency of analytical servicing and servicing documentation needed is determined based on business segment profile, relationship credit risk, economic capital and total exposure.

All CIB hard dollar credit exposures art required to have a documented servicing plan. The frequency of the "scheduled" servicing, whereby the portfolio manager is expected to prepare a servicing memorandum depends upon the Borrower Default Grade. In addition to the scheduled servicing events, the portfolio manager is expected to perform on-going monitoring using the established "Alerts" process. The alerts are based on the triggering of pre-established thresholds. For publicly-held companies, the trigger basis is equity price movement or rating agency ratings changes. For privately held companies, various performance measures serve as the trigger basis.

Servicing and monitoring processes are usually appropriate. As mentioned above, several operational changes focused on improving turn time and reducing servicing intervals, such as the end-to-end process in GBG and the implementation of portal in CIB, need to be monitored closely to make sure that ongoing credit analysis does not suffer. We and the OCC have also recently suggested to CRR that, given the uncertainty in the economy now, that the streamlines servicing requirements should be revisited for appropriateness.

PORTFOLIO MANAGEMENT & REPORTING: ***Satisfactory***

Credit risk mitigation has been managed to date primarily through loan sales and securitizations, but recently has evolved to use credit derivative products as well. Deals done are reported in a number of MIS packages, such as the CRPC package, CRC package, CIB Risk Return Committee package.

In CIB, a portfolio management subgroup, Credit Products, is charged with trimming excess exposures and limiting concentration risk in the large corporate portfolio. Besides housing the investment grade and leveraged finance syndication desks and the Special Situations Group, Credit Products also houses the Public Portfolio Management Group. This group enters into short-based CDS positions to offset exposure. A separate group called Private Portfolio Management focuses on the traditional ways and means of credit portfolio management through sales of problem loans in the portfolio. The OCC recently conducted a target examination of the Public Portfolio Management (PuPM) and the Credit Products Group and concluded that overall PuPM activities are satisfactory. In addition, a Jan 2007 Internal Audit of PuPM also resulted in a satisfactory rating.

For the GBG portfolio, the centralized corporate risk management group is responsible for taking corrective action. The risk management group can also mandate the use of CDS to hedge credit exposure on a top down basis.

Within Credit Risk Management, there is another group that is more focused on a bank wide hedging program to address the risks from a top down view.

(For more details, see comments under CREDIT RISK MITIGATION and USE OF CREDIT MITIGANTS sections.)

COUNTERPARTY CREDIT AND PRESETTLEMENT/SETTLEMENT RISK MANAGEMENT: ***Fair***

Counterparty credit risk exposure is predominantly with financial institutions with limited exposure to high risk entities. The volume of activity is considered modest and no material risk is posed to the institution. Weaknesses in control systems, however, lead to a "Fair" risk management environment. These system weaknesses contribute to less comprehensive netting, MIS limitations, and limited stress testing. Management is working to enhance the systems through the implementation of Adaptiv, which should resolve many of these issues. The project remains on target for completion by October 2007.

Due to the system's limitations, exposure is aggregated for all counterparties without the ability to properly net. Since commensurate collateral is required, there is no undue risk to WB. Management has worked to establish interim solutions for several products, but cross-product netting is largely unavailable. That being said, the majority of counterparties are middle-market customers with just a few trades in one product and a lending relationship, thus eliminating the need for cross-product netting. There are very few credit lines established and trades are largely approved as they occur. Thus, it is much easier, though work-intensive, to monitor counterparty exposure as compared to large dealer banks. Wachovia's largest exposures are with dealer banks who have deep two-way trading relationships are more diversified.

Credit and equity derivative exposure is calculated using tables of risk factors derived from analyses of historical or implied volatilities, typically leading to conservative potential exposure results. While these methodologies are being enhanced, the OCC's Risk Analysis Division has reviewed and accepted the current methodologies. Total credit exposure aggregation for a borrower/counterparty is not automated, but can be identified quickly. In spite of the system deficiencies, management asserts 99% of exposure is captured through automated and manual processes.

MIS does provide aggregate and global exposure levels, but could be enhanced. Primary MIS is provided monthly to the CIB Risk/Return Committee and includes exposure summaries by product, exceptions, MTM by Borrower Default Grade, and significant exposures sorted by MTM and PSR (both in total and by product). Management does monitor exposures daily, but the MIS associated with this is unclear. Taking a full inventory of MIS will be a key part of the June 2007 examination of counterparty credit led by the OCC. We also intend to assess credit risk management and obtain a full understanding of the benefits and limitations associated with the new Adaptiv system. Current stress testing will also be a focus. To date, comprehensive stress testing has been delayed until Adaptiv is in production.

Counterparty Credit Risk Management is integrated into overall Credit Risk Management and is staffed by competent personnel. They exhibit appropriate independence and routinely monitor limit compliance, reporting through the CIB Risk-Return Committee. There is satisfactory initial and ongoing credit analysis. Credit enhancements are appropriately used and monitored. Margin collateral positions are evaluated daily and calls made on deficient positions. Defined cure periods and actions to be taken are documented in master agreements. Valuation disputes are uncommon, but are resolved timely.

CREDIT RISK MITIGATION: ***Satisfactory***

Wachovia has a dual approach to using credit mitigants, one at the line of business level (Public Portfolio Management) and the other in the corporate credit risk management function (CRM).

Public Portfolio Management (PPM) has been mandated to support the CIB franchise by ensuring that CIB can deploy credit capital in pursuit of client relationships through all stages of the economic and credit cycle. PPM supports CIB through active credit risk management, reducing the impact of credit losses in the strategic loan portfolio. The group has two main units: Credit Portfolio Manager Group and Portfolio Strategy Group.

The Credit Portfolio Manager Group is organized by industry and performs market-based analysis to determine possible credit actions. The Portfolio Strategy Group is more focused on taking an active role in credit management and houses some of the more complex models, including their Active Portfolio Construction (APC) model which estimates portfolio credit losses through the cycle.

The principal functions of the PPM group are to:

- Develop fundamental and value opinions for each sector and significant names in order to recognize negative credit migration in the early stages
- Buy CDS protection on single name and sector exposures in the strategic loan portfolio that are at risk of negative credit migration
- Buy CDS protection on concentrated single name and sector exposures
- Recommend loan sales to Private Portfolio Management to combat migration and/or concentration risks where there are relative value or liquidity benefits versus CDS
- Recommend macro-risk positioning of the strategic loan portfolio plus balancing activities (size, ratings distribution, tenor) to the Portfolio Management Committee
- Invest in bonds, loans, CDS and other debt securities of names and sectors that are not concentrations

The credit risk mitigation function housed under the Credit Risk Management (CRM) is more focused on a bank wide hedging program to address the risks from a top down view. It is charged with reducing earnings volatility due to credit losses and improving the efficiency of regulatory and economic capital use. As of April 18, 2007, the program consisted of $10.75 billion in corporate CDS indexes (CDX) and $250 million of protection in CMBS CDS indexes (CMBX).

(See also PORTFOLIO MANAGEMENT & REPORTING and USE OF CREDIT MITIGANTS sections.)

PROBLEM LOAN MANAGEMENT*: Strong*

Wachovia's problem loan management is strong. Wachovia's policy entitled "Transfers to Special Situations Group or Special Assets Management" generally requires that loans rated FDG of 7 or worse (criticized) be transferred to the primary workout groups at Wachovia. For a criticized account to remain under line management, the credit weakness must not be severe and there should be a reasonable likelihood of it being upgraded to a "Pass" grade within a short period (usually six months). Retention of criticized loans by the line requires the approval of the unit's chief risk officer.

There are two primary workout functions at Wachovia. The Special Situations Group (SSG) manages the criticized asset portfolio of Credit Products within the Corporate and Investment Bank. The group's objective is to maximize the value of the portfolio in a manner that is consistent with the overall goals of Credit Products and CIB. Among these goals are minimizing losses, reducing non-performing loans and credit capital and diminishing the volatility of the portfolio. The activities performed in the group relate to managing individual loans by employing workout and restructuring techniques.). The last Internal Audit Report of SSG rated the group Satisfactory and Internal Audit also rated overall inherent risk of this entity as LOW.

The SAM Units are the bank's regional workout group, which handle resolutions outside of the Capital Markets area. With each region, there are typically multiple teams at various locations. SAM credits are evaluated by CRR in the normal course of examination of the LOB. The purpose of SAM is to rehabilitate the individual credits where they can be returned to the relevant Portfolio Management Group for more normal monitoring; other options are to workout the credit exposure by foreclosing on the collateral, a troubled debt restructuring or placement of the loan in an asset held for sale category or the bulk sale of assets to the secondary market. The SAM group has locations throughout the footprint including Charlotte, Philadelphia and Atlanta. Internal Audit assessed the risk for this entity as LOW.

SAM and SSG prepare problem loan reports (1108's) on all borrowers documenting the current financial position, current workout or restructure status, and action plans with upgrade/downgrade triggers delineated. They have engineered effective restructuring agreements, which have reduced exposure to the senior creditors and allowed many of the distressed companies to access the high yield markets. The bank's willingness to actively dispose of problematic loans and leases at reasonable discounts has significantly reduced criticized and classified levels.

A policy exists that requires that quarterly attestation by an appropriate supervisory level account officer that will evidence that 1108's (problem loan report) for material credits have been reviewed during the quarter. Material credits will are defined as those exposures in excess of 10MM and exposures classified as non-performing (BDG of 9.5).

Both SAM and SSG have enjoyed success in liquidating assets once they are assigned to them. The liquidation of assets has primarily been through sales in the secondary market or through bank refinancing or Wachovia has opted not to

continue their participation. During 2005 and 2006, the bank made substantial reductions in problems credits in this manner. The OCC reviews of problem credits have concluded that management develops clearly articulated action plans and strategies to facilitate timely collection. These action plans and strategies are delineated in the 1108 report on problem loans. The timely transfer of credit responsibility to the collection group is generally effective, though there have been some lapse.

The retail collections areas are functioning in a satisfactory manner. These collection areas are centralized and highly automated. The effective collection function has contributed to the bank's low loss rate and has a positive impact on the quality of risk management.

CREDIT CAPITAL: *Satisfactory*

Credit Risk Capital at Wachovia encompasses both wholesale and retail exposures and represented 65% of economic capital at YE 2006. The calculation and methodology development of credit risk capital resides in the Portfolio Management Group. Credit risk capital represents the loss in value our loans, leases, letters of credit, and other credit instruments could suffer measured at a high confidence interval (99.96%)

Economic Capital for wholesale credit risk capital is calculated using KMV's portfolio manager. It is based on specific assets in the portfolio. The drivers of wholesale credit risk capital are: Expected Default Frequency (EDF), LGD, term, size and industry. These inputs drive economic capital allocation through CPMI and COMPAS to the business units that hold and manage the exposures.

Economic Capital for retail credit risk is also calculated using KMV's portfolio manager. This capital amount is based upon specific product and risk combinations. The input parameters for consumer credit risk capital are developed by the STAR (Structured Transaction and Analysis Group) in partnership with the lines of business. Products include: Prime Equity Lines, Home Equity Loans, Auto Loans, Student Loans, Other Secured, Unsecured and Mortgages. Risk characteristics applicable to most consumer loans are Loan to Value, FICO score, and origination channel. The PMG calculates credit capital factors at granular levels and then rolls them up to product levels which are provided to COMPAS. Capital for retail exposures is not calculated on the individual instruments but on clusters that share similar product and risk characteristics. It is currently not as advanced as commercial credit risk capital given the lack of data on individual consumers.

Economic Capital is highly integrated into Wachovia's credit process. As mentioned in the Limits section, capital guidelines are set for any borrower/relationship by credit grade by LOB. Recognizing that the economic capital process is highly judgmental and assumption-driven, the cushion between the level of economic capital and tangible common equity (TCE), would seem to indicate sufficient capital to support the level of credit exposure. Credit risk capital ($15.8 billion) is primarily attributed to wholesale and retail exposures and represented 65% of economic capital (after diversification), which is well under 65% of TCE of $31.3 billion ($20.4billion).

Wachovia is part of the Economic Capital Horizontal now in progress. We expect to learn much from the results of that horizontal.

THIRD PARTY TOOLS & SERVICES: *Satisfactory*

Reliance upon third party tools and services with the wholesale portfolios is largely extended only to "household name" data sources such as rating agencies, KMV and others. On the other hand, third party tools are more prevalent in the consumer credit decision making processes. Vendor reliance appears reasonable and tools are highly customized to meet specific business risk management needs.

As mentioned in the MODEL VALIDATION section, any new Material Model (as defined in the Model Risk policy) whether internally developed or purchased from an external vendor, and any significant changes to an existing Material Model, must be appropriately validated by as qualified and independ3ent party prior to usage. Unless delegated to another business unit as provided in the Model Validation Policy, that validation will be performed by the Model Validation and Approval Group (MVA) in Market Risk Management.

Examples of Wachovia's use of third party tools and services is their choice of SunGard's Adaptiv system to use for

counterparty exposure. One of the most widely used tools, however, is KMV Moody's that is used to help monitor the commercial portfolio and in the calculation of economic capital. There are also situations where Wachovia uses consultants to help with specific projects where they need outside expertise. An example of this was the use of consultants (Ernst & Young) to help them with scorecard development.

__INTERNAL CONTROLS AND AUDITS: Satisfactory__

CREDIT ADMINISTRATION: *Satisfactory*

Servicing and monitoring procedures are usually appropriate. On the corporate side, servicing guidelines are developed in conjunction with risk management with servicing interval and content specified by type and size of credit. These guidelines are documented as policy in the Risk Policy Online. Untimely servicing events are tracked and reported to senior management. The OCC has usually found servicing processes acceptable, although they have noted that there are sometimes issues with servicing backlogs. Management has several efficiency initiatives that are changing servicing intervals based on risk, such as the use of Portal in CIB. As mentioned earlier, we and the OCC have recently suggested to CRR that, given the uncertainty in the economy now, that the streamlines servicing requirements should be revisited for appropriateness. (See ONGOING CREDIT ANALYSIS section above.)

On the retail side, the Asset Quality Monitoring report provides a good overview and LOB and risk managers have satisfactory MIS to manage the risk. (See ONGOING CREDIT ANALYSIS section above.) Collection efforts on problem credits are administered through two business units, one for CIB called Special Situations Group (SSG) and one for GBG called Special Assets Management (SAM). (See detailed discussion about these groups in the section PROBLEM LOAN MANAGEMENT.)

LOAN SECURITY INTEREST & COLLATERAL MANAGEMENT: *Satisfactory*

Wachovia's portfolio is highly collateralized, with 79% of the commercial loan portfolio secured by collateral and 99% of the consumer loan portfolio secured by collateral or guaranteed. As discussed above, commercial servicing interval and content is specified by size and type of credit.

Wachovia has a policy re real estate appraisals to provide guidelines and procedures for obtaining appraisals, ensuring the quality of appraisal content, reviewing and monitoring collateral values, and ensuring compliance with Wachovia standards and federal laws. Appraisals must be ordered through Real Estate Valuation Services (REVS). The Risk/Credit Officer receives appraisal quotes from REVS that will list the cost and timing of the assignment, but appraiser names will not be supplied. The selection of the appraiser is based solely on the cost and timing to ensure appraisal independence. Once a bid is selected, the Risk/Credit Officer will be informed of the appraiser's name.

GoldenWest has an appraisal process of which they are very proud. All appraisals are either done in-house or by outside appraisers that have gone through the GoldenWest training. GoldenWest points to their loss record as proof that their collateral valuations are accurate.

LOAN REVIEW / CREDIT AUDIT: *Satisfactory*

Credit Risk Review's (CRR) mission is to independently monitor the bank's commercial and consumer credit exposure by performing ongoing reviews of credit underwriting and servicing practices. CRR also evaluates portfolio quality and risk management practices while providing guidance and risk-related support services to stakeholders. CRR's review efforts provide the opportunity for timely identification of systemic credit process weaknesses and prompt resolution. This proactive approach allows CRR to detect changes in the amount and types of credit risk being taken.

CRR's has direct reporting responsibility to the Board of Directors' Risk Committee, but administratively is part of the Credit Risk Management organization. CRR's organizational position within CRM needs to be re-evaluated as a result of BASEL II (i.e., independence).

CRR is comprised of Commercial and Consumer teams staffed by approximately 47 commercial and 8 consumer professionals, respectively. Commercial reviewers are primarily located in Charlotte, with additional reviewers located in

Jacksonville and Philadelphia. All Consumer reviewers are based in Charlotte. Each team has its own specific function and area of expertise to ensure adequate coverage of the bank's credit portfolio. The last internal Audit review of this area assessed the overall inherent risk ranking of CRR as Medium. There were no key issues and no matters requiring attention. Internal Audit conducts an annual review of CRR because of the unit's critical role within Wachovia's credit risk management structure. The last three internal audits of CRR have been rated Satisfactory.

Review coverage for 2006 was approximately 32% which is slightly above previous years in the 28% range. The OCC in 1Q2007 conducted a target examination of Commercial Credit Risk Review to determine the adequacy of CRR's process in identifying and monitoring Wachovia's commercial credit risk and concluded that it was effective. Based on our meetings with CRR and our review of their reports, we agree with that assessment.

Internal Audit also plays an important role in the management of credit risk and has made significant progress over the last several years to drive a cultural change where the audit function is viewed as an integral business component and an independent control function. As a result of the improved stature of Audit, audit-identified control weaknesses are receiving more timely and appropriate management attention. General Auditor Schild is scheduled to retire in 4Q07, and former Controller David Julian has been named his successor. This should further improve Audit's standing as Julian brings to the position a high level of stature within Wachovia. The OCC views Audit Committee oversight and support as appropriate, and audit management processes, reporting and staffing satisfactory. Based on our meetings with Audit and our review of their reports, we agree with that assessment.

MODEL REVIEW AND VALIDATION: ***Satisfactory***

A new Model Validation Policy and the Model Risk Policy were approved in March 2006. According to the Model Validation Policy, any new Material Model (as defined in the Model Risk Policy), whether internally developed or purchased from an external vendor, and any significant changes to an existing Material Model, must be appropriately validated by a qualified and independent part prior to usage.

Unless delegated to another business unit, that validation is to be performed by the Model Validation and Approval Group (MVA) in Market Risk Management. MVA is charged with responsibility for validation and annual review of all models developed by CIB and all models used to determine regulatory capital under Basel II, but has not yet validated all these models. (Given its recent formation and the volume of models, this is not surprising. Should this be the case next year, our rating would not be Satisfactory.) Credit risk review is charged with independently reviewing the process for all models impacting credit risk capital, including development and validation. The Audit Division, as part of its normal audit procedure, is to evaluate compliance with policy by business unit model users and owners..

LOAN LOSS RESERVE PROCESS: ***Satisfactory***

The Corporate Loan Loss Allowance Committee, chaired by the Chief Risk Officer, meets quarterly and is responsible for review and approval of the allowance for credit losses as well as for policies and procedures connected with its determination. The Risk Committee of the Board of Directors reviews and approves policies governing the determination of the allowance for credit losses.

While Wachovia's ALL as a percentage of loans is lower than its peers, its loss history supports its adequacy. ALL as a percentage of charge-offs compares favorably to its peers, admittedly aided by its previous absence from a credit card issuer role. The adequacy of the ALL can be seen below:

	3/31/06	6/30/06	09/30/06	12/31/06	3/31/07
ALL/Loans	1. 08%	1. 07%	1. 03%	.80%	.80%
ALL/Nonperforming Loans	452%	488%	520%	272%	213%
ALL/Net Charge-offs	12.92X	14.60X	6.50X	6.01X	5.44X

Wachovia's model for the allowance for loan losses has four components: formula-based components for both the 1) commercial and 2) consumer portfolios, each including an adjustment for historical loss variability; 3) a reserve for impaired commercial loans; and 4) an unallocated component.
For commercial loans, the formula-based component of the allowance for loan losses is based on statistical estimates of the average losses observed for commercial loans classified by credit grade. Average losses for each credit grade reflect the annualized historical default rate and the average losses realized for defaulted loans.

For consumer loans, the formula-based component of the allowance for loan losses is based on statistical estimates of the average losses observed by product classification. Average losses for each product class are computed using historical loss data, including analysis of delinquency patterns, origination vintage and various credit risk forecast indicators.

For commercial and consumer loans, the formula-based loss components include additional amounts to establish reasonable ranges that consider observed historical variability in losses. Factors they may consider in setting these amounts include, but are not limited to, industry-specific data, portfolio-specific risks or concentrations, and macroeconomic conditions. At December 31, 2006, the formula-based components of the allowance were $1.9 billion for commercial loans and $1.3 billion for consumer loans, compared with $1.9 billion and $739 million, respectively at December 31, 2005. The increase in the consumer component reflects the GoldenWest and WestCorp acquisitions.

Wachovia has established a specific reserve within the allowance for loan losses for impaired loans (commercial loans on non-accrual status). They individually review any impaired loans with a minimum total exposure of $10 million in the Corporate and Investment Bank and $5 million in other segments and reserve for each based on the difference between the loan's carrying amount and the loan's estimated fair value. No other reserve is provided on impaired loans that are individually reviewed. At December 31, 2006, the allowance for loan losses included $14 million and the reserve for unfunded lending commitments included $5 million for individually reviewed impaired loans and facilities. This compares to $10 million and $7 million respectively at December 31,2005.

The allowance for loan losses is supplemented with an unallocated component, reflecting in part the inherent uncertainty of estimates and is designed as a final tool in fully capturing probable incurred losses in the loan portfolio. The amount of this component and its relationship to the total allowance for loan losses may change from one period to another. Wachovia anticipated that the unallocated component of the allowance will generally not exceed 5 percent of the total allowance for loan losses. At December 31, 2006, the unallocated component of the allowance for loan losses was $160 million, or 5 percent of the allowance for loan losses, compared with $135 million, or 5 percent, at December 31, 2005.

The reserve for unfunded lending commitments, which relates only to commercial business, is based on a modeling process that is consistent with the methodology described above for the commercial portion of the allowance. In addition, this model includes as a key factor the historical average rate at which unfunded commercial exposures have been funded at the time of default. At December 31, 2006 and 2005, the reserve for unfunded lending commitments was $154 million and $158 million, respectively.

The OCC conducted a targeted exam earlier this year of the Allowance for Loan and Lease Losses (ALLL) and the Allowance for Credit Losses. The exam's objectives were to:

- Determine the adequacy of the ALLL and reserve for unfunded commitments
- Assess compliance with the recently issued Interagency Policy Statement
- Review the changes made in 2006 to the commercial and consumer HVS
- Review the recently adopted consumer and credit card methodologies and
- Determine the effectiveness of management's corrective actions to address deficiencies noted in prior OCC and Internal Audit exams

While the OCC reviewed the corporate-wide analysis, their conclusions applied only to the national Bank charters. They concluded:

- ALLL and reserve for unfunded commitments are adequate
- Methodology, policies and procedure are satisfactory and in overall compliance with Interagency Guidance, although there are several areas where bank practices could be strengthened to ensure ongoing compliance
- Changes in the commercial and consumer HVSs were appropriately supported
- Recently adopted consumer and credit card reserving methodologies are satisfactory
- Management adequately addressed the previous recommendations

Given the addition of GoldenWest and its unusual risk profile, we will need to make sure that we join the OCC is making sure that the ALLL is sufficient, not just in aggregate but for each entity.

Market Risk

Inherent Risk

Inherent Market Risk Ratings	Inherent Risk: Market Risk										
	Banking Book				Trading Book						
	Balance Sheet Positioning	Size and Stability of Earnings & Capital	Hedging Effectiveness	Types of Interest Rate Risk	Size of Positions	Liquidity and Complexity of Positions	Strategy and Business Mix	Components of Price Risk	Stability of Earnings & Performance History	Diversification	Position in Market
Subfactor Rating	Mod	Mod	Lim	Mod	Lim	Mod	Mod	Mod	Mod	Con	Mod
Factor Rating	Moderate				Moderate						

<u>**Inherent Trading Book Market Risk***: Moderate Risk*</u>

Wachovia's trading activities are primarily conducted in the Global Markets Group (trading activities and underwriting securities) of CIB through the four divisions: Global Rates, Structured Products, Credit Products, and Equity Products. As in past years, and even more so at present, the level of risk as measured by VaR and non-VaR sensitivities is low relative to capital and the size and stature of the institution. Moreover, for 2006, only 16% of the Global Markets revenues were from trading P/L, with 60% resulting from fee based revenues. The fee revenue and relatively stable trading P/L is closely tied to Wachovia's investment banking philosophy to be a customer facilitation business and to exploit those markets where a high degree of customization is needed. As a result, the structured products division as well as structured rates, and equities products are the mainstay of Wachovia's trading business. This specialization introduces other sources of risk however warranting the "moderate" rating.

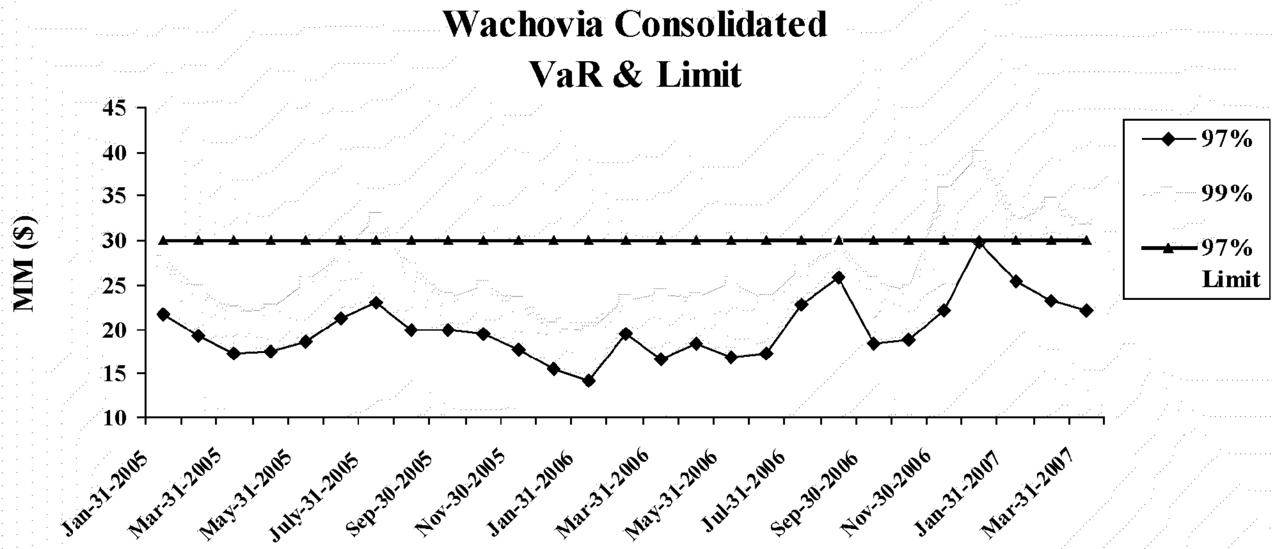
The complexity of the these products, the difficultly in pricing and hedging, trade booking difficulties, the limited customer base, accounting complications, and the associated warehousing of assets for impending securitizations all elevate the level of risk beyond what is evident from the VaR measures. This is the also the principal growth area for Wachovia. Increase in annual Global Markets revenue from $3.4 billion in 2005 to $4.1 billion in 2006 is almost entirely attributed to structured products. Both credit products trading and equity products trading has scaled back volumes and scope of products significantly focusing on the core origination client base. Proprietary trading remains an insignificant risk.

Beyond the complexity, Wachovia finds its risk highly concentrated in the structured products businesses and in traded credit risk associated with financial institutions. The size of the warehouses, individual loans in the warehouses, and of the deal offerings are expected to increase in 2007. If these markets were to falter Wachovia would suffer moderate trading losses. But more importantly, its principal source of trading and fee revenues would be curtailed, as would the loan origination business which supplies the warehouses. Efforts to significantly expand into new products sets outside of structured products and geographies have not materialized although initial steps to establish a presence in Europe and Asia have been completed. Europe and Asia products will be predominately structured products and real estate lending.

VaR (measured as 1 day holding period with a 97.5% confidence level) as a percent of tier 1 capital remains well below that of peer institutions. And the limit of $30 million is also low and represented only 4.6% of actual trading revenues for 2006. Moreover, trading revenue in 2006 constituted only $1 billion of almost $30 billion in corporate revenues. This supports the view that the VaR limit of $30 million is low as noted above. In addition, trading assets at $46 billion

represent only 6.5% of total corporate assets. Nevertheless, the investment bank and trading functions have strategic importance in providing a complete suite of products to the banking and retail brokerage clients. Volatility in revenues and VaR usage is primarily a result of the build-up and subsequent securitization of warehoused securities. This metric is further distorted by asymmetrical accounting treatment of warehoused loans and hedging. VaR is computed on the warehoused loans but the associated assets are not reflected in GAAP trading revenue.

Risk metrics have actually decreased from 2006 while revenue as grown. Growth areas continue to be all structured products as well as high yield bond and hybrid debt underwriting and trading.



Size of Positions: ***Limited Risk***

Size of positions can be measured in several ways, by volume of transactions, size of revenue production, and risk metrics. By all these measures Wachovia positions are small with the exception of structured products. As a percent of tier 1 capital the VaR limits of $30 million is less that .1% of Corporate Tier 1 capital. Actual VaR usage has remained below the limit throughout the year. As a result, risk of loss to the institution from trading is small.

However the majority of that risk resulted from structured products which on average is 90% of the total VaR usage. This risk is primarily due to the warehoused assets associated with CMBS and CDO securitization. This business does occasionally result in residual assets booked at Wachovia. These positions are small, valued independently, held as AFS assets, and do not influence the revenue, VaR, and risk management discussions below.

Size of positions as measured by VaR, has shifted significantly between products over the past year. In the past Wachovia has had a substantial position in short term options trading (interest rate and mortgage options). The decrease in VaR levels for Global Rates can be attributed to the decline in this business as a result of the flat volatility curve and decreased customer demand. Equity VaR has decreased as a result of exiting the largest equity desk which traded exchange traded options and indices. Finally credit products VaR has decreased due to a strategy shift from trading in many credit names to focusing only on those industries and specific names in industries with which Wachovia has an established relationship. Over the same period the level of VaR associated with structured products has increased primarily as a result of increased warehouse activity. While overall activity has increased, the CDO warehouse activity currently carries a low exposure to subprime residential assets after taking some limited losses in March.

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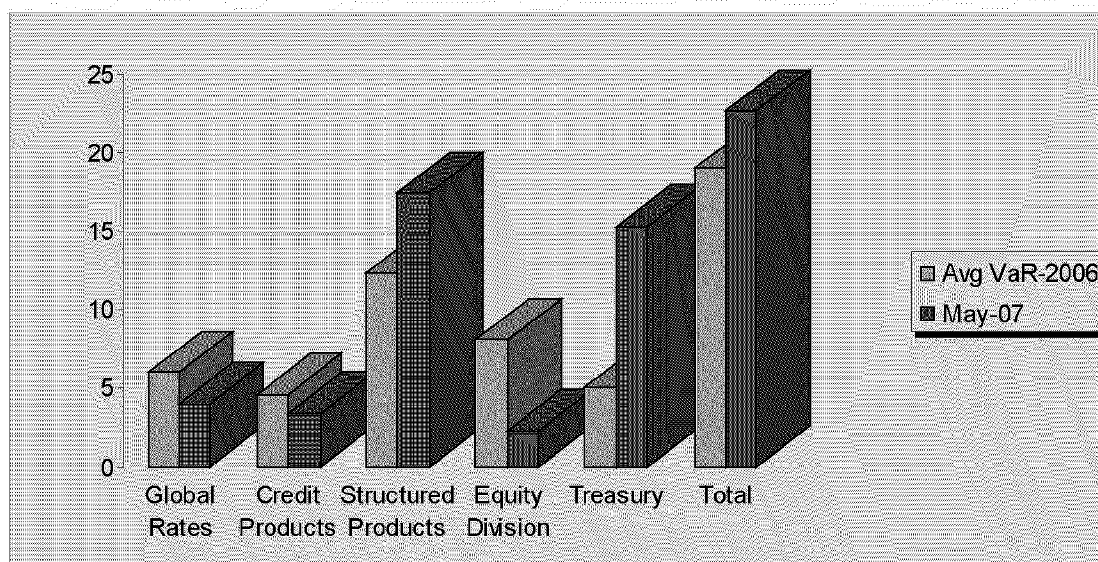
No VaR limit increases are anticipated for any division or desk during 2007 other than structured products. No limits increases have been proposed at this time. Nevertheless, positions are expected to grow given that CIB has been approved to add an additional 285 sales and trading staff. This will primarily affect the build-out of Europe and Asia, and the transfer of the commercial real estate lending group in the General Bank to CIB.

Another source of price risk to Wachovia associate with large positions, is introduced from a business outside of the Global Markets Group. Commonly called Treasury risk, this primarily represents the trading book run by the Corporate Treasury function and the mark to market credit derivative positions used to hedge the credit risk in the banking book portfolio. This risk has being growing over the past year and at March 30, 2007 was $12.8 million representing 58.1% of total corporate VaR, versus $1.6 million or 12.3% at March 30, 2006. Of this amount only about $2.0 million in VaR is associated with true trading positions which are concentrated in MBS, interest rate swaps and interest rate options. The Treasury positions are approved at the senior management level and are not truly trading positions. As a result, the VaR associated with Treasury activity is now excluded from the $30 million VaR limit.



Measured in terms of revenues, income from pure trading, excluding fee income, in 2006 was only $658 million or 2.2% of corporate revenues. Of that amount, $569 million resulted from the Global Rates trading. While structured products is the largest revenue generator for the Global Markets Group the majority of its earnings are from fees earned from securitization activities. For GAAP purposes the warehouse loans are not treated as trading however the hedges are. So, for 2006 Structured products posted a trading loss, but overall, positive revenues of $1.9 billion. For purposes of this analysis warehoused loans will be considered trading products and in fact are included in all the VaR metrics used for risk management (but not used for regulatory capital). When all aspects of revenue are considered, structured products represents 47% of the Global Markets Group revenues for 2006. The warehouses in notional terms were on average approximately $9 billion for the commercial real estate and $4 billion for the CDO warehouse.

Recently Wachovia brought to market a commercial real estate securitization totaling $17 billion, the largest in the industry's history for this type of deal. In general the commercial real estate deals done by Wachovia have grown from an average of $2 three years ago, to an average of $4 in 2007. The warehouse size has increase commensurately from $4 billion to $12 billion. Currently the warehouse supports more deals in the pipeline and bigger deals. While the size of these positions are large the virtually all of the interest risk is hedged and approximately 90% of the credit risk. However, hedging is based on the expected securitized structure not on a loan by loan basis. If the securitization market were to collapse the short term hedging of general credit spread movements would not protect against long term credit losses in the resultant loan portfolio.

The current size of positions has Wachovia positioned to lose money if credit spreads widen. Measured by CR01 or the dollar value of a basis point spread move Wachovia would lose $4.2 million per basis point widening. This is primarily a result of unhedged exposure in the warehouses and long CMBS positions. Global rates, the second largest source of trading risk is positioned for the interest rate curve to steepen. In a flattening environment driven by the long end move upward by 28bp Wachovia would lose $24 million. From an interest rate volatility standpoint the trading books are positioned for interest rate volatility to remain stable over the next few months. This type of positioning has been typical for Wachovia over the last six months with CR01 rising a falling as the warehouses build and then securitize. The size of positions does not pose significant risk to Wachovia except for the structured products warehouses were dependency on ABS and CMBS investors is crucial. Nevertheless, were the securitization market to evaporate Wachovia would be left with an accrual loan portfolio, of assets primarily originated by the institution, with a positive carry. Such a portfolio, even at the maximum warehouse levels of $20 billion would be manageable.

Liquidity and Complexity of Positions: ***Moderate***

While the majority of revenue earned by the Global Markets Group is from relatively complex products including, CMBS, CDOs, ABS, equity linked notes, structured interest rate products, total return swaps, and leveraged finance/hybrid debt securities, this is fee based revenue rather than trading. Securitized products and hybrid debt underwriting do not carry any market risk to Wachovia once they are sold. On the other hand, structured notes and derivative contracts having embedded optionality, must be continually hedged throughout the life of the instrument. In the case of Wachovia, the hedging is accomplished primarily with liquid instruments. The day one profit on the trade for many of the structured note and derivative trades is deferred due to unobservable model parameters.

Transparency of pricing has traditionally been a measure of liquidity. Structured rates, equities, and correlation trading depend on pricing model to determine the value of the trade and the value of the hedges. However these are tailored instruments created for specific payoffs and not actively traded from a liquidity standpoint. These positions cannot be sold off as with cash instruments or closed out with an identical offsetting derivative contract as with vanilla derivatives. Therefore the risk revolves around accurate price modeling, basis risk capture, and stress testing.

The biggest risk in these cases is the basis risk between the hedge and the long term contract. Basis risk is monitored through greek risk metrics, basis risk desk limits, and stress tests but remains a challenge. The structured rates and equities portfolios are new businesses therefore still relatively small but growing. Correlation trading was scaled back dramatically in 2005 and remains a small exposure.

Wachovia does not trade many of the traditionally illiquid products: emerging markets debt, exotic currencies, or distressed debt, and commodities trading is still quite small. Nor is it a market maker in exotic option products. While trading is substantial in the Rates book it is for hedging customer positions. Bermudan swaptions, equity cliquets, variance swaps, and barrier options are positioned as hedges to structured notes. As such, effectiveness of the hedge can be impeded by the illiquidity of the hedge instruments and subsequent price swings, again a matter of basis risk.

At the heart of position liquidity risk at Wachovia is the relationship between the lending origination activities and the presence of the broker dealer in the market. The “originate to distribute” model is central to CIB’s success. Virtually all the corporate lending activity is reliant on a distribution channel to be profitable. Wachovia has become a market leader in this business for commercial real estate, and small business loans. It is quickly growing it abilities in leveraged lending, bridge lending and the associated high yield bond trading. These are all liquid markets with many institutional investors and well developed yield curves. However, the underlying whole loans in most cases do not have a well developed market and depend on the securitization structure or a bond take out to provide the liquidity, price, and operational format to make the business plan work. Since most of the loan originations are accounted for as accrual assets, the loss of distribution would not be seen in trading losses but in balance sheet inefficiencies, funding costs, and high overhead as the origination machine slowed down.

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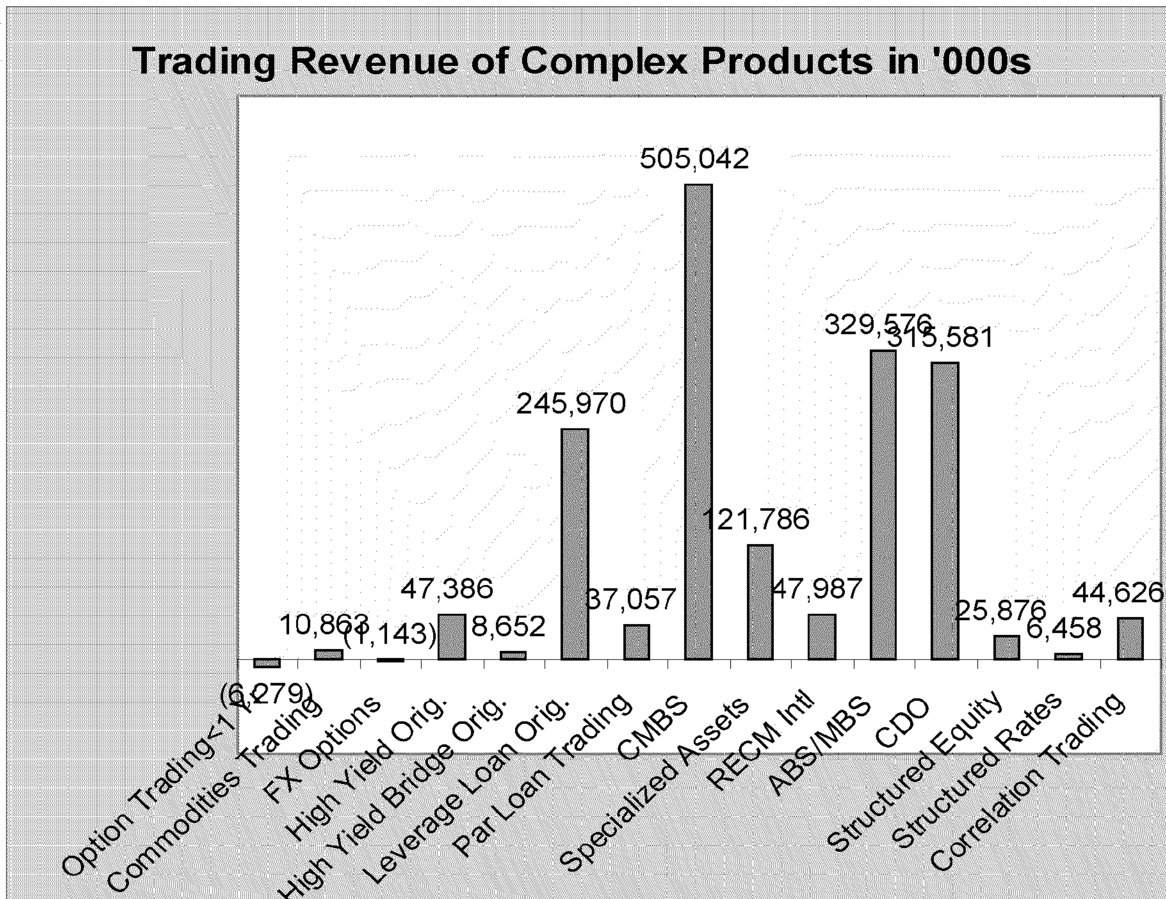

Private Equity

At year-end 2006, non-trading equity investments within CIB totaled $1.9B or 1% of total securities and trading account assets. The majority of non-trading equity investing takes place within WB's private equity investing arm, Wachovia Capital Partners (WCP), with limited relationship investing taking place within Structured Products ($35MM) and Real Estate Capital Markets ($114MM). WCP's total portfolio of $1.9B is split relatively evenly between fund and direct investments, totaling $1B and $800MM, respectively.

In 2007, WCP plans to significantly alter its private equity strategy from being entirely proprietary based to managing funds for third party investors. This new funds management activity adds an additional layer of risk (fiduciary risk) and elevates the importance of detailed reporting and strong valuation practices. The change in strategy will initially be accomplished through the sale of WCP's entire direct portfolio with the exception of some public investments and other investments with foreseeable exits occurring in 2007 through a SPV. Thus far, WCP has distributed private placement memorandums to 10 institutional investors and is waiting for indications of interest. A liquidation event is forecasted for Q2'07 or Q3'07. WB will retain a 50% to 80% interest in the direct portfolio, which it is referring to as "Fund I".

WCP is also planning to raise funds to start "Fund II". The group will make larger investments and distribute limited partnership interests through WMG, CMG, and to institutional investors. WCP's typical direct investment has approximated $35MM, but will increase to $75MM to $100MM for the new fund. In fact, WCP is in the final stages of due diligence for two direct investments totaling $175MM in commitments. These commitments will be seed investments for "Fund II". "Fund II" will be approximately $2B, and WB will retain an estimated stake of 75%. In addition, to the direct fund raising business, WCP is close to hiring a partner to direct a "fund of funds" that will be distributed similar to the plans for "Fund II".

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Strategy and Business Mix: *Moderate*

This inherent risk is designed to indicate a heightened risk when new or complex products are routinely introduced, and new strategies are often pursued. Wachovia's risk is considered moderate because by failing to successfully develop multiple sources of income the institution has become too little diversified as noted below in the Diversification risk. As noted above for 2006, almost half of the Global Markets revenues were from Structured products. An from a risk viewpoint on average 90% of the Global Markets VaR (not including the Treasury activities) is from Structured products. The CIB business is heavily dependent on the success of this business. Moreover, when looking at the source of CR01 risk it is also driven by structured products, in particular the commercial real estate warehouse. At 5/2/07 the warehouse contributed $3.4 million/bp in credit spread sensitivity to the total trading book CR01 of $4.2. The second largest contributor to credit spread risk is credit products which contributed only $439K loss per basis point move in spread. However, this represents a concentration risk in that on average two- thirds of the traded credit risk, outside of structured products, is from financial institutions.

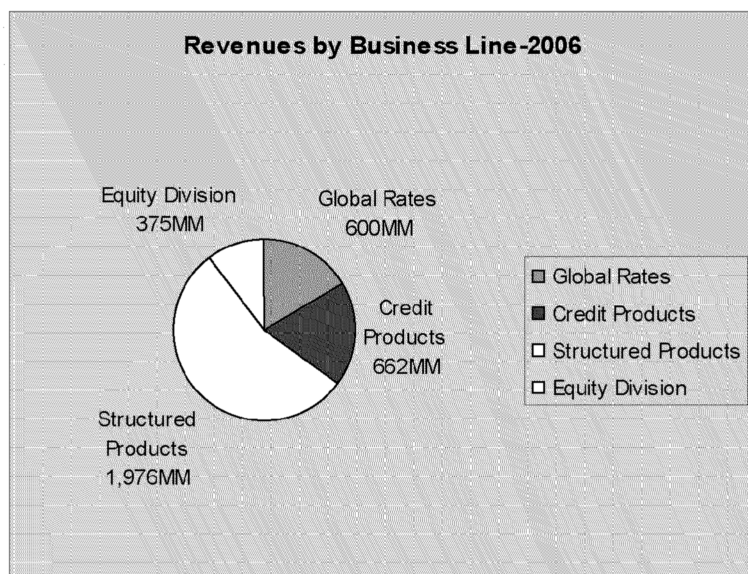
Wachovia has recognized this concentration of risk and has continued to explore diversification opportunities. The company has a history of changing strategies regularly. A major acquisition in home equity lending and securitization failed. Equity products has focused on research, equity financing for investors, exchange traded options, and index trading only to jettison those plans. Now the focus is on structured equity products and fund of funds financing as new strategies. Credit products has attempted to be a broad based dealer in credit products only to fail, dismiss traders, and is now focused only on core credit names and industries. Correlation trading grew quickly, encountered valuation problems, then scaled back dramatically. Plans for expansion in Europe and Asia have been developing for several years but have yet to materialize. Most recently, the decline in interest rate volatility and loss of small mortgage company customers has made the under 1 year option trading book unprofitable whereas it used to be a major earnings driver.

Proprietary trading remains small, however management talks of expanding desks. Currently, the main proprietary desks are convertible bond trading desk in the US and in London, cash equities trading, credit products – principal investing, and the prop desk run by the Corporate Treasury group. These desks trade traditional products where the risk can be measured, hedged and monitored with a high degree of accuracy.

As one of the smaller institutions in the investment banking business, and being located outside of New York, Wachovia has met with continued challenges in developing any significant business outside of structured products. Its strength continues to be exploitation of markets where customers need highly tailored instruments, prefer to rely on their principal banking relationship, or Wachovia plays a secondary role in the transaction. There are no plans for either a fixed income or equity prime broker. New products approved within the last year include: Forward starting swaps or fx forwards contingent on an underlying leveraged buyout, creating and trading Wachovia credit indices, trading ETF's on credit indices, financing closed end municipal mutual funds through TOB structures, non-recourse CDS, participation swaps, preferred stock CDS, resort/vacation home securitization warehouse, Thailand residential lending, Korean commercial real estate lending. No significant new risks are being introduced with the exception of geographic risk for the Asian products.

Leverage finance received approval to add project finance as a new business and hired a five member team to run the operation. Also within Leverage finance the limit for bridge lending was increased from $1 billion to $4 billion and trading Loan CDS was added to approved products.

That being said, revenues are diversified within business lines. Global rates revenues are fairly evenly distributed between interest rate products, municipal finance and foreign exchange. Likewise credit products has an even split between high grade and high yield. Structured products has a little more than half of revenues from real estate and the remainder from other asset classes and ancillary revenues. Two thirds of equity revenue came from underwriting with Wachovia rarely taking the lead. As noted above strategy and business mix takes on a lower risk characteristic when considering the steady fee income and the focus on customer facilitation transactions rather than proprietary trading.



Components of Price Risk: *Moderate*

Optionality is present at Wachovia in the interest rate trading, FX trading, municipal desk, and equities trading. The commodities trading is insignificant. There is very little trading of options on CDS, options on CDO's, options on ABS or options on CMBS. Likewise, residential mortgage back trading, conducted in the Global Rates division is a very small desk limiting the exposure to prepayment risk. While the credit derivative and asset back option trading has been approved, to date it has been done on a very limited basis. The structured note businesses have products designed to provide option payouts but this business is not designed to take a view or trade optionality. As noted above, the goal and challenge with these products is to hedge out the risk accurately. As a result overall option risk is not high and primarily exists in the most liquid markets.

The short dated option trading desk which incurred the majority of option risk for the firm has recently failed to make revenue projections and is pursing a different strategy thus contributing to further decline in option risk. Currently the largest vega exposure is for interest rates products (which includes interest rate option and mortgage option trading), and the municipal trading desk, which each had about $1.5 million vega exposure. The largest option exposure for the company is in the equities business which at $9 million vega still represents modest exposure and is well below the vega limit for the business.

The municipal trading desk makes up about a third of the Global rates division revenues, it has introduced several new products in the last two years and has plans to expand increasing its revenue projections by 70%. This has traditionally been seen as a traditional banking business and little time has been spent analyzing the risk, product set, or client base associated with this desk. From a price sensitivity and position size point of view, this has emerged as one of the riskier trading desks.

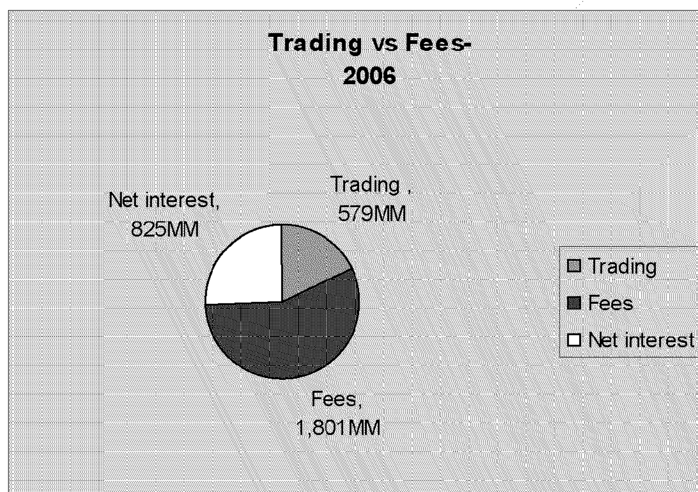
The warehouse positions are not hedged as individual loans. Nor is the credit risk of individual loans assessed or risk rated. Rather the portfolio is viewed as a growing securitization structure with approximately 1/8 of the portfolio sub investment grade and 7/8 investment grade. This mimics the typical subordination established by the rating agencies. VaR is calculated based on price changes in the CMBS spreads or CMBX index. The portfolio is hedged with TRS on the CMBX index (various tranches), spread TRS, government bonds, and interest rate swaps. The interest rate risk is practically eliminated. But the credit spread risk represents the one of the largest basis risk to Wachovia. Additional structured product basis risk arises from ABS CDOs being hedged with CDS on CDO's, and CLO's hedged with CDS on CLO's. Much of this is not captured by VaR and is controlled by basis risk limits.

Other moderate exposures to price risk include interest rate curve risk evident in all the Global rates businesses (interest

rate products, municipals, structured rates, FX, and commodities). The largest DV01 exposures are for interest rate products and municipal trading which are $273K and $348K respectively, and structured products which most recently had a DV01 of $522K. While not considered a proprietary trading book, generally the non-hedged portion of the customer flow business in rates is positioned with a view on curve twists. Likewise the FX book generally takes a small directional view but judging from the FX P/L where the trading income is only 1/10 that of marketing, this price sensitivity is inconsequential. Some indication of the modest price component risk is indicated by the various rate shocks, curve twist shocks, and FX stress tests conducted daily. The most severe impact to the company is a parallel upshift in US rates to by the biggest 1 week move seen in five years, in which $79 million would be lost.

Stability of Earnings and Performance History: ***Moderate***

The most important point to note regarding the Global Markets Group earnings is that the majority of the revenues are fee generated and the business is primarily customer flow related. While volatility can still occur from this business strategy it is not price driven but rather changes in product mix, customer service, marketing efforts, or distribution capabilities. There were two market events that affected the Wachovia trading books. The equities jump in late February and the subprime events during March. Both of these events had little effect on Wachovia's P/L.



A crucial point to analyzing Wachovia's earnings volatility is understanding the asymmetry of accounting and the nature of the warehousing/securitization business for the commercial real estate structured product. This product makes up the largest portion of the warehouse risk. The majority of warehoused real estate loans are originated by Wachovia. As such FAS 133 will not allow these assets to be hedged on a macro basis. For GAAP they are held as accrual assets and accounted for on a LOCOM basis. However from a risk standpoint the price sensitivity is important for the ultimate securitization and these assets must be hedged to protect Wachovia from loss during the ramp up period. The hedges are considered trading assets and are mark to market. Revenue reports only show the movement of the hedges not the valuation of the loans. The value of the loan gains or losses is realized when the securitization deal is priced, only then does it flow through the revenue numbers. Therefore, it appears that earnings are much more volatile than in actuality. The warehouse book is not constant, it grows until it reaches suitable deal size then drops dramatically as assets are sold into a structured. When the warehouse is large and the movements in the hedge values are significant. This particularly skews analysis at quarter or month end if there has not been a recent securitization. Likewise the interest carry associated with the warehouse fluctuates with the size and timing of securitization offerings.

With this in mind Wachovia's earnings have not been particularly volatile. In fact, the goal of the structured products business is to keep the warehouse hedged so that the only income will be from the sale of the securities. More recent quarters compared with past quarters exhibit more fluctuation primarily because the size of the warehouse has been growing relative to the rest of the trading books. The timing of the statement is also very important. At November, month end the warehouse was large and highly valued which means that the hedges were showing a loss. At month end December, several deals had just closed meaning that loan P/L was realized, the hedges were gone, and fee income

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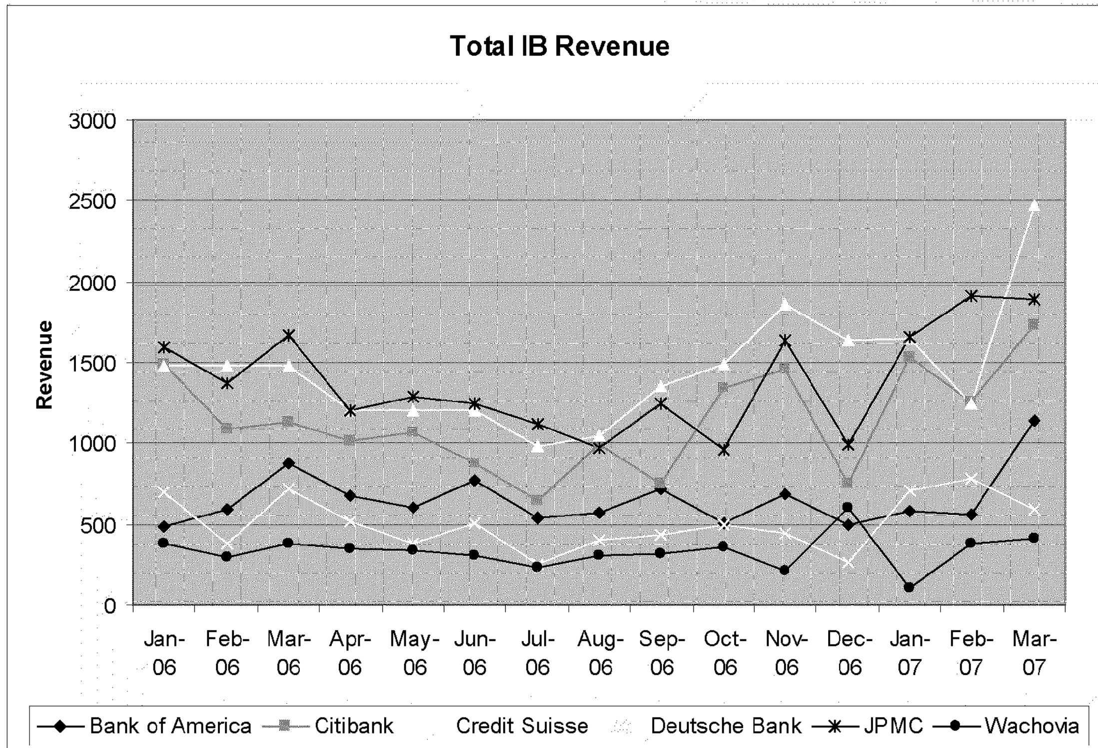
associated with the deals was booked. January, saw few deal closings so the realized loan value and more importantly the fee revenue was not booked. Again activity in February was light combined with large losses on the hedges (the associated gains on the warehouse were not apparent until March). This demonstrates above all the dependency CIB has on the structured product business.

Other than structured products the principal income volatility is from Global Rates which is expected given the main source of fixed income DV01, gamma, and vega risk is in those trading books. Leverage finance income fluctuates due to bond underwritings and loan fees rather than trading.



Backtesting results have been adequate. Backtests are done by desk and business line. Breaches occurred only at the business line level. The only significant business line breach was the $38 million dollar loss on 2/28/07, from the CDO warehouse positions due to CDO spread widening following subprime events (this was compensated for by an equal income from securitization fees on this inventory). There was a $12 million dollar loss on CMBS spread widening several days later.

One of the main sources of earnings volatility over the years has been Wachovia's changing strategies. Most recently the wide coverage of credit trading and the exchange traded equities strategies lost money and were exited. A study of Wachovia's customer base has not been undertaken by FRB examiners. However, the relationships with hedge funds is not extensive due to the lack of a prime brokerage business. Given that Wachovia is not a major dealer bank and does not make markets in commodity-like instruments it is doubtful that they would lose customers on a wide scale due to pricing. Wachovia's focus on niche businesses and financial engineering tend to cater to a loyal client base.

Diversification Risk: ***Considerable***

As noted above concentration of revenues and risk from the Structured products business is significant. This trend is likely to increase as the majority of new products relate to this business. Even the expansion into new geographies as planned for Asia and Europe center around structured products and real estate lending.

Wachovia's presence in the markets outside the US is minimal. However, loan originations from Europe have been

increasing and by year end 2007 almost half of the warehoused positions are expected to be from Europe. The funding vehicle for European products will be a newly charted Irish bank called Wachovia Securities International. While these loans are funded in the US currently, there are tax advantages to having them booked in Ireland. The ultimate goal is to have securitization debt sold out of the Irish bank as well.

Diversification of risk provides a similar picture as revenue. At May 15, measured in terms of VaR for the Global Markets Group, Equities contributed 11.7%, Credit products 17.2%, Global Rates 20.2% and Structured products 87.2%. (These percentages do not add due to the diversification benefit achieved across trading divisions). The Treasury group which has a small trading book and large credit hedges constituted 62.8% of the total corporate VaR amount. While levels move daily this break out is representative of the typical distribution of risk. From a VaR stress standpoint, based on the four historical disaster scenarios, the worst loss is $1.2 million due to the global rates trading in a 1994-like bond market sell off due to FOMC policy changes.

Diversification may increase somewhat given the traction that is developing with the Equity structured products business, however current expectations are that this will only replace the revenue lost with the exit of OTC option trading. Leverage finance is also a fast growing business and likely to compose a greater share of Global Markets revenues this year. Leverage finance revenues increased 63% from year end 2005 to year end 2006. The revenue forecast for 2007 indicates another 34% growth for this year. It should be noted that these revenue amounts include loan origination fees which make up the largest amount of revenue. Project finance was also added in late 2006 as a new product offering for Leveraged finance. At 13% of the Global Markets revenues leverage finance is on par with Global Rates as a contributor to overall revenues for the first quarter of 2007.

Wachovia has one of the largest retail brokerage and wealth management businesses in the US. The Equities and Structured products businesses are exploring opportunities to distribute product to through this retail franchise. In fact, the equities structured product already has grown its business through access to the retail customers.

Position in the Market: ***Moderate***

Wachovia is the market leader for Commercial Real Estate Securitizations. In March it closed the largest CMBS deal in the markets history at $17 billion. The institution is a market maker in CMBS secondary trading and for corporate debt for which they acted as underwriter.

According to Bloomberg League tables for 2006 Wachovia ranks as follows:

Debt – Global bonds	#14
Debt – US Bonds	#11
US Equity	#12
Syndicated loans	#4
M&A	#19

Wachovia's internal tracking of league table activity reports that they were 4th for high grade loans, 4th for high grade preferred securities, and 8th for high grade bonds. They have lead very few high yield bond offerings but are selling group members occasionally.

Trading Book Market Risk Management and Controls

Trading Book Market Risk Management and Controls	Risk Management and Controls												
	Board and Senior Management Oversight			Policies & Procedures		MIS and Risk Monitoring				Internal Controls and Audits			
	Board Governance Structure & Oversight	Management Governance and Oversight	New Product Approval	Policies & Procedures	Limits & Guidelines	Value at Risk & Backtesting	Stress Testing	Management Reporting & MIS	Trade Capture Process	Reserves	Price Testing	Model Review & Validation	Internal Audit
Individual Factor Ratings	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Fr	Sat	Sat	Sat	Sat
Overall Rating	Satisfactory			Satisfactory		Satisfactory				Satisfactory			

Risk management and controls remain satisfactory and have in fact improved since last year in several area, continuing the trend noted in the previous RAP. Our assessment is based on ongoing supervision report reviews, discussions with management, joint examinations with the OCC covering Structured Products, Equity trading, and Market Risk Management. Five internal audits have been conducted since mid-year 2006 that pertain to trading activities. These were all rated satisfactory. Most Matters Requiring Attention from the Regulators and Internal Audit have been addressed at least partially.

The assessment of controls is heightened by the current cost control initiative undertaken by Wachovia. Becoming more efficient is one of Wachovia's key strategic initiatives. Wachovia has created the Efficiency Improvement Program (EIP) and has communicated operating efficiency ratios (OER) to Wall Street for each of its four primary LOBs. As of December 31, 2006, Wachovia reported a record low OER of 57.38%, versus the 63.72% reported one year earlier The Wealth and CIB lines of business continue to lag stated efficiency targets. In view of this effort and the insufficient infrastructure in CIB noted in the past, vigilance around resource allocation is warranted. Market risk management, CIB Technology, and Finance have continued to build staff and systems during 2006 and 2007 and remain committed to a state of the art platform for trading and investment banking.

The completion of staff hiring, installation of a new VaR calculator, and rewrite of many policies has kept to time lines proposed by management. Many of the new Market Risk Management staff are from outside of Wachovia and bring new level of sophistication and trading experience to the company. Production errors associated with VaR calculation and position reporting have been greatly reduced. Trader mandates have been completed for all trading desks except for Structured products. Automated position reconciliations are now conducted. Additional stress tests have been added. Daily desk level risk reporting is now available for all desks and includes limit usage information and a full complement of risk sensitivities. A P/L attribution gap analysis has been conducted and a rudimentary report is now produced. Finally the model validation function has developed a sound policy, a template for the validation documentation and has reduced its backlog of non-validated models. New products continue to be added to the VaR specific risk model and equity specific risk model is currently under review by regulators

Major areas highlighted by regulators still to be addressed include:

- Completion of the information technology projects which has three important end-user functions: client identification, security master files, and position data base.
- Completion of full development of P/L attribution for all trading businesses lines which currently is in place for only about 40% of the trading revenues.
- Completion of ad hoc stress testing
- Analysis of proxy use for VaR
- Consistent implementation of validation policy and documentation consistent with the template
- Completion of trader mandates for Structured products

In addition to Regulatory mandates, management has developed additional goals for the improvement of market risk management and controls. These items, scheduled to be completed throughout 2007 and 2008, include:

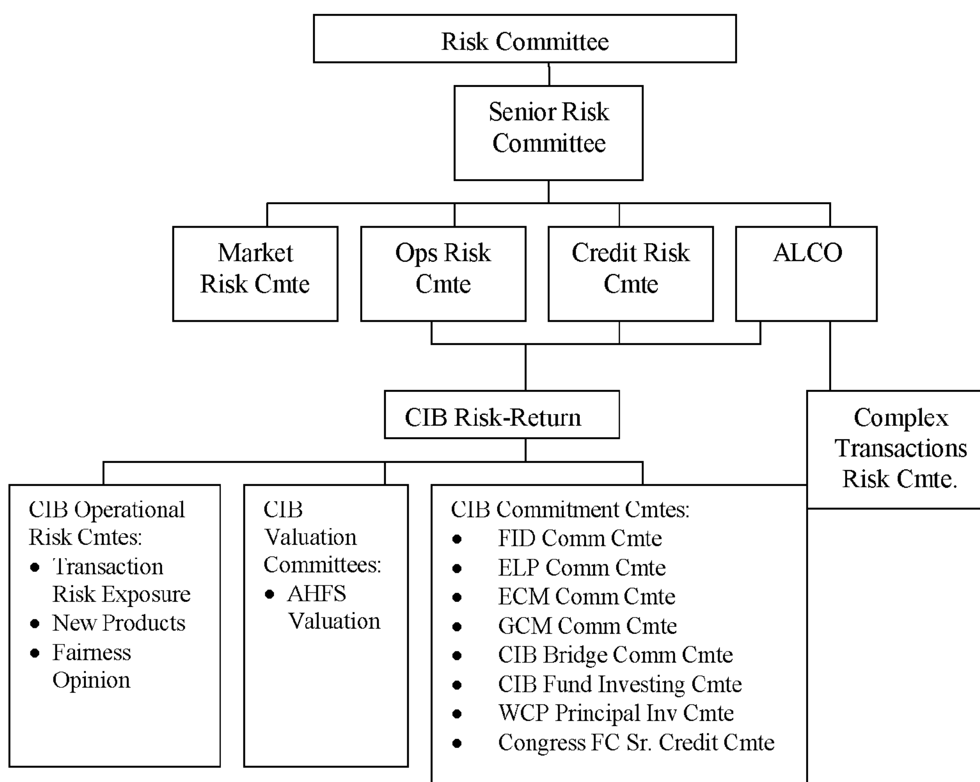
- Changing methodology for general market risk VaR from historical simulation to Monte Carlo simulation.
- Moving both specific risk calculation and general VaR calculation to the same Mars system
- Generate weekly regulatory capital reporting instead of quarterly
- Build limit monitoring database to house exceptions and approvals for limit breaches
- Build an asset class risk report to cut across business lines

Board and Senior Management Oversight

Board Governance, Structure, and Oversight: *Satisfactory*

The board has an adequate understanding of the Wachovia market risk profile, and provides effective oversight of risk management practices given the moderate level of market risk exposure. The board of directors and management of Wachovia have established a corporate risk governance process focusing on major risks such as business strategy, liquidity, credit, market, interest-rate and operational. The two board committees overseeing the risk governance process are the Audit Committee and the Risk Committee. Meeting bi-monthly, the Risk Committee is the functional committee overseeing and reviewing the policies, procedures and practices in the risk areas noted above. Pertaining to market risk, the Risk Committee annually reviews the charter of the Market Risk Committee, and the Market Risk Policy. The Risk Committee receives from the Market Risk Committee information on Wachovia's trading activity, market risk limits in terms of VaR, as well as, information about the assumptions used in the VaR model. Trends impacting the various markets and products traded are documented to inform the board about changes in financial markets.

The board of directors Risk Committee delegates authority for operational oversight to the Senior Risk Committee, and the Asset/Liability Committee. The Market Risk Committee reports to the Senior Risk Committee through the Asset/Liability Committee.



Management Governance, Structure, and Oversight: ***Satisfactory***

Senior management is informed of trading book market risk matters, and provides effective supervision of activities throughout Wachovia. Members of the Senior Risk committee hold quarterly meetings covering the level, trend and direction of market risk with information provided by the Asset/Liability Committee. The Asset/Liability Committee reviews activity monthly in the financial markets, new products impacting market risk, and securitization activities and exposures. Committees providing information and recommendations to the Asset/Liability Committee concerning market risk are the Market Risk Committee, Complex Transaction Committee, Model Risk Committee and the New Products Committee.

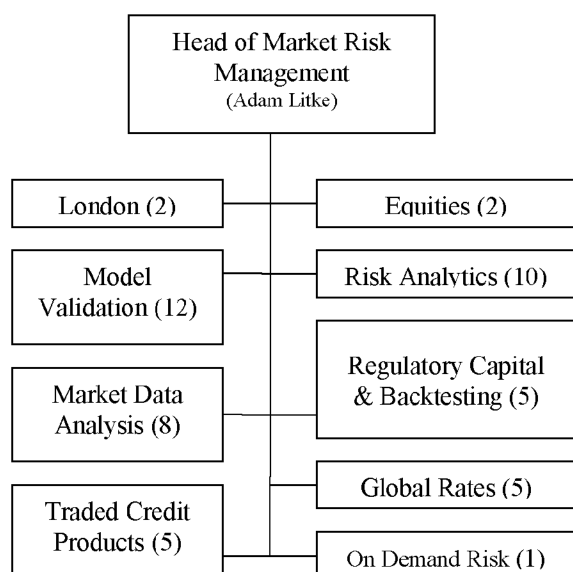
The Market Risk Committee is appointed by the Asset/Liability Committee to oversee regulatory and economic market risk in the trading books of Wachovia. Meeting quarterly in conjunction with the Asset/Liability Committee, the Market Risk Committee reviews the risk/performance of business units, monitors market exposure and usage of limits, approve VaR and stress limits of the lines of business and Wachovia, and monitor the adequacy of the market risk management structure. The Market Risk Committee draws most of its information from the CIB Risk/Return Committee. The CIB Risk/Return Committee meets monthly and is responsible for evaluation and oversight of major risk taking activities across CIB, covering market, credit, operational and reputation risks inherent in CIB portfolios, inventory, positions and activities.

Market Risk Management is responsible for executing the market risk policies established by the Asset/Liability Committee and Market Risk Committee. Market Risk Management provides oversight of market risk activities, and assistance in other risk management issues as part of CIB Risk Management. The manager of Market Risk Management functionally reports to the CIB Chief Risk Officer. The manager of Market Risk Management also, has the responsibility to monitor associated market risks throughout Wachovia. These responsibilities include, VaR measurement and reporting, market stress testing methodologies, periodic reporting of market risk, enforcement of the

firm-wide model validation process, development of all analytics for derivative counter-party exposures, and ensure the limit overage procedures are followed.

Management has assembled a staff of trading and market risk professionals with experience, expertise and depth to manage the business lines in a safe and sound manner. Market Risk Management is responsible for the measurement and communication of market risk activity to senior management. The Market Risk Management team monitors trading in credit products, global liquid products, and equities. On-Demand-Risk relates to a technology/database/reporting project to provide non-VaR risk metrics at the desk level, as well as measure market risks across various product types throughout Wachovia.

Model Validation and Market Risk Analytics provide support for market model adequacy and market model development respectively. Market Data Analysis and Regulatory Capital and Back-testing have been combined to provide more efficient use of market report development for internal and external uses, along with market data analysis. The market risk oversight personnel in London, England have moved under the Head of Market Risk Management. London market risk oversight will cover trading activity in Wachovia Securities International Limited.



New Product Approval: *Satisfactory*

The new product approval process is satisfactory. Wachovia has a written policy and procedures detailing objectives, criteria, responsibilities, administration, and documentation requirements for the introduction of new products into business lines. The new product approval policy is part of the CIB Group Guidelines to manage the business objectives of the group.

A new product is any product or initiative that is not currently offered by CIB and presents new credit, market, regulatory, legal or operational risks. Even when a proposed new product differs slightly from, or is a variation of an existing product, there may be certain aspects (i.e., risk management, accounting, etc.) that are significant enough to require the product be evaluated as if it were a new product. Specifically, characteristics that may require a product or change to be reviewed include:

- Would require a change to existing systems or procedures
- Cannot be processed utilizing an existing system
- Does not readily fit into an existing risk measurement methodology
- Cannot be priced through existing procedures or requires a new pricing model
- Requires new credit or risk management policies or monitoring procedures to be established
- Presents any unique regulatory, legal, reputation or other significant risk to the Corporation

Each new product requires a product sponsor, who performs preliminary due diligence, and prepares a written proposal to begin the review process. The product sponsor also is responsible for issues identified in the review process, and those noted by the CIB New Products Committee. However, before the review process begins, the sponsor must gain approval from the CIB Risk-Return Committee to go forth with the review. The CIB Risk Return Committee determines that the proposed new product is appropriate for the goals and objectives of CIB and Wachovia. They also provide approval of the product concept, and the expenditure of resources for the new product review.

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Upon approval from the CIB Risk-Return Committee, the new product proposal is presented to the New Products Committee which meets monthly to review presentations of new product proposals with sponsors and business unit managers. The New Products Committee determines if additional due diligence is required, identify risks and issues related to the new product, raise issues and concerns to senior management, and finally, provide approval of the new product by risk discipline. The New Products Committee will also be responsible for establishing follow-up reviews of approved products. These reviews verify the compliance of the business unit with commitments made during the initial new product approval process.

Corporate Risk Discipline representatives are designees of the New Products Committee members, and include personnel from Credit, Compliance, Finance, Legal, Market Risk Management, Wholesale Operations, Information Technology, Tax and other departments as needed. The risk discipline designees inform risk management of any transaction which could be considered a new product, review new product proposals, propose solutions or risk mitigation for issues and risks surrounding the new product process, and determine the size of the infrastructure to support the new product.

In addition to the new products review process and committee, Market Risk Management has developed its own new product approval process. The risk management perspective of new product approval begins with trading management providing to Market Risk Management with a product or model description. The Market Risk Oversight officer for the particular trading unit becomes the sponsor for the new product approval process. Also, MRO officer will collaborate with trading management to develop limits and guidelines. In addition to the setting of trading mandates, the MRO also ensures that model validation, VaR, counterparty credit and PNL attribution are parts of the new product approval process.

Policies and Procedures

Policies and Procedures: ***Satisfactory***

Much effort has been put into upgrading policies and procedures during the past year. This is particularly true at the business level where new trading policies and trader mandates have been written. The mandates describe trading strategy, products used, all trading limits including VaR, stop loss, and sensitivity limits, and the authorities for approval of overages. A model validation policy and template for validation documentation was also completed, closing a significant gap in corporate standards. The Market Analytics group has been consolidated and is responsible for reviewing policies for adequacy and updating. The company continues to make more policies available on various websites.

High level policies for trading desks continue to be adequate, although general in scope describing only the basis limits and functionality of the Corporate and Investment Bank and Market Risk Management. Market risk policies are consistent with the board of directors stated market risk profile and strategic objectives. Risk management roles responsibilities and reporting are well defined in policies and procedures and reflect most of the practices covering identification, measurement, monitoring and control of major trading risks.

In spite of improvements, some policies still need addressing and the OCC has recently put in place a MRA regarding the inadequacy of the Market Risk Capital Policy and resulting practices which lead to lower capital charges being applied to some products not eligible for market risk capital treatment. Inconsistent language across policies continues to contribute to confusion about actual practices and the correct context of the policy.

Policies and procedures for Private equity/merchant banking activities are considered comprehensive and establish an effective framework for decision making, monitoring, reporting, and compliance with regulations.

Limits and Guidelines: ***Satisfactory***

The limit structure controls all inherent trading risks and is granular in terms of risk measures for all material products. Limits and trading guidelines are established at the CIB Division level, for business lines and trading desks. Limits at the desk level are comprehensive and include VaR and non-VaR limits. Aggregate market risk for Structured Products,

and Credit Products desks is monitored using 10-day trailing loss triggers, and limits. A yearly loss limit is in place to shut-down trading in a line of business if losses become excessive. The Equity Division is currently developing 10-Day trailing and yearly loss limits. The Global Rates line of business does not have 10-Day and yearly loss limits. However, limits measuring option risks, and interest rate risk are in place for liquid products.

Limits are independently monitored by risk management. Market Risk Oversight Officers are assigned to each business line. Calculation of VaR and non-VaR limits such as DV01, Spread01 and option sensitivities are automated. Non-VaR limits, for 10-Day and Year-to-Date losses are manually calculated and reported to the Market Risk Oversight Officers by Finance. Reviews for limit breaches are done each trading day. Limits are well-communicated and documented in policy, and reviewed annually by board appointed committees. Each trading product has policies and procedures which define the positions and/or risks monitored. The Market Risk Committee monitors the market risk exposure and usage of approved limits. This information is provided to the Asset/Liability Committee quarterly. Information concerning market activities is passed onto the Senior Risk Committee. Each month the Senior Risk Committee meets to discuss the level, trend and direction of risks such as credit, market, operations. Annually this committee also approves the charter of the Market Risk Committee. Finally, the Risk Committee annually reviews the charters of the Market Risk Committee as well as other committees under it.

Limits are consistent with the low risk appetite of the board of directors. However, management does not tie limits to a capital measure. Nor is there supporting reason for limits. The overall VaR remains at $30MM, with the desk limits having experienced few changes in the past year. Instead of seeking larger trading limits, Trading and Market Risk Managements have focused upon improving market models and processing systems.

Monitoring of limit utilization is in place and is adequate. Limit excesses are detected and reported to senior management on a daily basis. Upon the determination of a limit breach, the trader responsible for the breach is contacted and given a preliminary assessment of the overage. If a breach is determined to have actually have occurred, the Product Head, Market Risk Management Head, Market Risk Oversight Product Head and Trading Manager of the desk involved with the limit breach are all contacted.

<u>**MIS and Risk Monitoring**</u>

Value at Risk and Backtesting: ***Satisfactory***

As noted in the past, the basic VaR calculation covers the material risk, can be aggregated, and have passed regulatory scrutiny for many years. The VaR model includes general market risk VaR (including the commercial real estate warehouse), and specific risk VaR modeling for the majority of credit products. The equity specific risk model is currently under review by the regulators. For approximately 1.7% of the capital charges associated with market risk (as prescribed by the Basle market risk amendment), VaR is not calculated according to the approved general market risk model and uses some other method. This market risk is primarily associated with traded residential whole loans which are not risk rated. (Traded commercial real estate loans which have not been risk rated pose the same challenges but the majority of these are originated by Wachovia and not marked to market for GAAP purposes).

Significant improvements in the past year include the full implementation of the in-house VaR calculator, called Mars for all VaR calculations, 1-day at 97.5%, 1-day at 99%, 10-day at 99%, modeled specific risk, and the various stress tests. Direct feeds and automated reconciliations to the new system have greatly improved the reliability and consistency of VaR calculations. Since last year the equity positions have been moved from full revaluation to delta/gamma approximation, the same valuation methodology as used for the rest of the trading books for general market VaR calculations. The amount of VaR difference due to this methodology change was analyzed by Market Risk Management and reviewed by examiners and determined to be immaterial.

The majority of significant price sensitivities are captured in the current VaR method, however callable bond and MBS VaR calculations ignore optionality. Management argues that this is acceptable given the small positions in these instruments. There is no analysis or policy regarding the omission of price sensitivities

While general market VaR uses historical simulation with the Mars system, the specific risk model uses Monte Carlo

simulation calculated outside the Mars environment. The institution has been allowed by the regulators to combine the general market VaR with specific risk VaR using a specified formula. Wachovia remains on target with plans to use an integrated Mars calculation for both these risk by 2008, and at the same convert from historical simulation to Monte Carlo for the general market risk charge.

Also noted in the past, documentation of VaR methodology is insufficient. While the system used for calculating VaR has improved, the documentation has not. Due to the priority of implementation pricing model documentation used for calculating risk sensitivities have not yet been completed for many of the models installed in the new system. The list of risk drivers (curves, spreads, volatilities) is incomplete. Analysis and justification for proxy use continues to be inadequate. Justification for omission of some risk drivers such as option sensitivity for MBS securities continues to be insufficient. Finally the complete use of proxies, and documentation for the use of the proxies is not completed. In addition to routine proxies for time series there are defaults to generic security types for positions where insufficient positions characteristics are not available in the Mars feeds. There have been problems with management expanding the use of an existing product methodology for VaR to new products. Mar's from the OCC and FRB are in place for these issues.

VaR and backtests are produced at the 99% confidence interval for all the trading desks. Backtests are conducted daily, with adequate processes, but one that is manual and requires call to product controllers for missing data. The analysis of backtests is thorough. For the last year there were no breaches at the corporate level or the CIB level. The only desk that had a VaR backrest breach was Structured products which had a one day trading loss of $38 million due to CDO warehouse spread widening following the turmoil in the home equity markets.

As with many companies there are some desks or products that use a different system for front office analytics (greek sensitivities) than those used in Var. Only products on Calypso and Imagine use the same pricing models to analyze sensitivities for both front office and VaR. And for FX which is in Calypso the front office uses another risk analytics tool rather than use the sensitivities in Calypso that feed VaR. Management has determined that this lack of consistency does not cause a material misrepresentation of the VaR estimate and should not interfere with using the most sophisticated tool for the front office.

Stress Testing: ***Satisfactory***

Stress testing meets the standards for institutions with this level of trading. Global Market Group-wide stresses are applied to all the trading books daily. In addition, some desks employ limited stress testing. Stress limits also apply to all desks. Several changes to the this standard regime of stress testing were proposed last year at this time but were not implemented until recently due to challenges associated with the Mars system implementation. The new methodologies represent an effort to make the data easier to interpret and more helpful to decision makers. The methodologies are sound and have been approved by regulators. These approaches require more effort to calculate and are an indication of better systems and better risk management taking effect.

One area that still falls behind other institutions is the use of ad hoc stress testing. Wachovia has not been able to implement this due to IT system deficiencies. In the past, the old VaR calculator required all stresses to be hardwired in the code. Now with Mars these stresses are possible. However the first step was developing the GUI which has taken longer than anticipated. The first application for the new interface was the risk factor stresses mentioned above. The FRB and OCC have had outstanding Mar's related to this since last year. Direct stresses of diversification and correlation benefits and updating for likely market events will not be done until ad hoc stresses are in place. Management has indicated that this should happen by the fourth quarter.

The 2007 changes to stress testing affects the two types of stresses currently used; disaster tests and extreme risk factor shifts. The risk factor shifts replace the market shocks of 4 standard deviations, applied to up and down equity prices, equity vols, flattening rally and selloff, FX up and down, FX vols up and down, Foreign rates up and down, US spreads, steepening rally and selloff, US swap spreads in and out, US rate vols up and down, mortgage vols up and down, and US basis in and out. These stresses were based on a one sigma move multiplied times four. Although the one sigma loss/gain was updated regularly there was confusion among managers as to what exactly the sigma shift meant for decision making purposes since it was not intuitive from a traders perspective.

In place of the standard deviation moves Wachovia now uses historical moves of risk drivers (spreads, rate curves, equity prices etc). These are based on the worst two week moves of the drivers over non-overlapping five year periods. All the five year periods available are averaged to get the stress moves. The shift is applied to the positions as though the shift would occur on a single day. The new shifts produce similar results to the old four sigma moves but are easier to interpret. For the most liquid products – Rates, and FX worst one week moves are used instead of two weeks. Data is updated every five years as a new five year period is available. CMBS spread historical data was unreliable so "reasonably severe" shocks are applied. ABS historical spreads, also not reliable, will be replaced with Corporate spreads. Rate shocks include curve twists as well as parallel moves as in the past, with the twist defined by the 2 year and 10 year point.

The four disaster tests (1987 equity shock, 1994 interest rate increases, 1998 Russian bond credit spread widening, and 9/11 market shock) will continue to be used with different dates that are more meaningful. These stresses do consider the interdependence of the credit and equity markets and liquidity risks are considered. The existing methods arrived at the start and end periods of the disaster based on the lowest/highest values of the risk drivers reached during the disaster. This assumed there was no opportunity to re-adjust, an unreasonable assumption. For 1987 equity stress the old dates were 10/15 to 10/26, with no adjustment in positions during that time. The new stress is for 10/16 to 10/19. This is adequate to stress extreme drop in equity prices combined with spread widening, extreme increase in implied volatility, and lower interest rates in the short end of the curve. This is considered a single day event so the period was shortened to a two day holding.

The 1994, interest rate increase and curve flattening previously last a year from 1/1 to 12/14. Now it is 11/14 to 12/14. They use the large interest rate moves over the entire period and apply them assuming they occur instantaneously. The shorted dates reflect application to a trading book versus a banking book. The 1998 spread widening went from a two month holding period to a four day holding period. It combines large spread widening with decreases in rates and curve flattening, and drop in equity prices (flight to quality). For the 9/11 shock the holding period was shorted by four days to reflect the seven days the markets were closed.

In addition to these changes there was a system change to the interface between position data and VaR calculations. A result of this changes was to achieve greater stability in the stress/disaster results. Fewer trades failed for unknown reasons, fewer intermittent pricing timeouts, and less incomplete exposures. Some products such as lookback options, and cliquets are now capable of being processed with a full complement of scenario results, unlike last year. The overall impart on stress VaR however has been immaterial due to the small positions in these instruments.

Management Reporting and MIS: *Satisfactory*

This rating is an increase from the "Fair" rating of last year. A particular area of notable improvement include the instances VaR production errors. It was not uncommon as recently as year end to have 15-20 product problems with VaR in a week. This included failure to run altogether, to missing position of risk factor data. Often previous day VaR had to be used for some positions. Those instances have decreased to approximately one or two minor production problems in a month. The regulatory capital calculation driven by VaR has been improved greatly with the conversion to the Mars system. The source positions and capital charges are now transparent but remains manually intensive.

VaR, and most other position and risk MIS is produced T+1. Trading Managers and Market Risk Management have the ability to see all desk positions intraday. However for risk sensitivities, only the Equity Division and FX desks have the ability to view intraday measurements driven by the official books and records across the desk.

Daily risk reports at the desk level are now available for the first time. These include multiple risk sensitivities, concentration information, stress information, and limit overages. Daily P/L reports are now available through the Finance web-site and instances of late P/L have been virtually eliminated. Reserve reporting is now produced on a quarterly basis. In the past Equity trading desk level reporting was virtually non-existent. Currently there is a detailed report with breakouts by product and risk. Risk management has developed a new risk management tool called "On demand risk" which reports risk sensitivities, and issuer risk concentrations across all books.

Management has conducted a gap analysis and project plan for P/L attribution. Rudimentary attribution reporting is now done but only capturing 40% of the trading books. Continued improvement is dependent on large scale systems upgrades which are underway. Management had hoped to achieve more coverage of P/L explain from existing information sources. However, the widespread use of spread sheets for position records in structured products and the lack of connectivity between finance and front office has made progress difficult.

The three-year project conducted by CIB Technology mentioned last year is on schedule. This project is comprised of three separate initiatives. One will enable client and issuers to be recognized across all platforms and establish the hierarchies for clients and for Wachovia's legal entities. Right now these hierarchies are entered and updated manually. The second initiative is a fully integrated books and records systems which eliminates the need for spread sheet position records and enables the existing front end systems Imagine and Calypso, to be connected. Finally this project will establish a master copy of security identification so that security/position characteristics will be described consistently across the company. This will eliminate the many defaults characteristics currently used for positions in VaR calculations.

The MIS reporting has been reorganized, consolidated, and increased in staff. The reconciliation process has significantly improved and is automated greatly reducing the chance of missed positions. Reconciliation errors are reported daily. The detail in standard report packages continues to improve with the most recent introduction being a weekly narrative of positions, risk, and P/L moves.

Wachovia still does not report risk or P/L from proprietary trading separately from customer flow business. However, as in the past the, the level of prop trading remains small.

The senior management risk package referred to as the Risk and Return Committee package has been expanded. There is a very good section on warehouse and structured product activity and leveraged lending activity.

Limit overage monitoring for desk level positions is available on the daily risk report. Individual trader limit monitoring is automated and produces a daily report. The approval of the overages and distribution of approval documentation is done through email and retention of records is not consistent. Wachovia is in the process of installing an over-limit data base to track and document overages and approvals. This issue has become more significant as the trader mandates and a full compliment of trading limits have recently been developed.

Trade Capture Process: *Fair*

As with MIS, trade capture has improved but still falls within the guidelines for "Fair" risk management. This is due primarily to continued reliance on spread sheets for risk management and middle office booking and the lack of straight through processing in some books. Improvements have as noted above, have included the automated Mars reconciliation process, more trading desks migrated off of spread sheets and are incorporated into the official books and records systems, and progress towards P/L attribution. Structured products continues to lack a comprehensive front and middle office system and relies more on spread sheets than any other desk.

As noted in the past the solution to trade capture and straight through processing is tied to and multi-facetted technology project that has been allocated ample resources and is on track for completion next year. Routine progress reporting is produced. Successful completion of this project has the attention of senior management, internal audit, and the regulators.

Currently, Calypso and Imagine are straight through systems. These are used for the high volume, liquid products: interest rate trading, single name credit derivatives, FX, and cash equities. Equity derivatives are also booked on Imagine but for structured equity products (the majority of the derivative business) this requires manual intervention and dis-aggregation of structures for proper booking. The main challenges for trade capture are basket trades, loan related trades, and capturing the reconstituted positions of warehouses to be securitized.

As noted last year, the OCC continues to emphasize that compensating process controls and low limits have been put into place to mitigate this risk. The extent of new product approvals and growth of products has been restrained until

better systems are in place.

Internal Controls and Audits

Reserves: ***Satisfactory***

There has been no significant changes in the reserve policies or procedures since last year. The rating continues to be satisfactory supported by the following description from the 2007 RAP. One change in policy while minor, further indicates Wachovia caution towards risk and its ability to control risk even without state of the art booking systems. The sale of loans from the retail mortgage company has traditionally had a 90 day reps and warranties guaranty consistent with industry standards, and an associated reserve. This year that guaranty was reduced to 30 days because of a softer market, and concerns about performance particularly with lower rated borrowers.

Reserve methodology is formalized in policies for Structured products, Rates, Credit Products and Equity Linked products. Major reserve classes are mentioned including EITF 02-03 reserves, model reserves, liquidity reserves, credit reserves and operational reserves. Release of major reserves is discussed. A reserve report is prepared monthly.

For equity derivatives model reserves are calculated on a portfolio basis each quarter. The amount taken is based on dealer quotes which are compared to model driven prices. Differences are translated into volatility point changes which are applied to the entire portfolio of like products. The amount will vary each quarter as dealer quote vary and as the composition of the portfolio varies.
This policy is a combination of price verification and model reserve.

TRS have a reserve for operational losses because of the manual process involved in calculating the value of the trade. It is calculated quarterly and is generally 25bp of the funded portion (hedge amount) of the trade. This is not truly a pricing reserve but an operational error reserve, and an indication that the business growth is ahead of the infrastructure.

For synthetic CDS and Correlation trading four reserves are maintained: EITF 02-03, substitution rights, liquidity, and correlation reserve (also referred to in the industry as model reserve). The policy says that CDO's on indexes tranches are recognized in revenue and only bespoke are reserved (this is consistent with industry). No EITF reserves are held for single name CDS.

Substitution reserve accommodates the contingency allowed in some transactions which grants the investor the right to substitute a different name for one or more names in the reference pool. A cap is established so that the P/L difference caused by the substitution does not exceed the cap. The reserve covers the amount of the cap. It will be released during the life of the trades as substitutions are made or at the maturity of the transaction.

A Liquidity reserve as with other derivatives allows the trade to be marked to the mid point with a price adjustment to the bid or ask as appropriate. On each trade the liquidity reserve is calculated and aggregated by reference entity and all entities summed for the portfolio. This process is done monthly.

Correlation liquidity reserve adjusts for use of the midpoint mark in the calculation of the base correlation. Broker correlation quotes on various indices are used to model bid, offer and midpoint implied correlations. The midpoint correlation is used as input to produce base correlations for valuing synthetic CDO's. As with single name CDS an adjustment is made to allow for the difference in pricing tranches at the bid or offer versus the mid point. This process is done monthly.

For the rates desks an operational reserve and a bid/offer reserve is calculated quarterly on a portfolio basis. The bid offer reserve is based on sensitivities of the positions and is broken into two parts; a delta reserve and a volatility reserve. All the delta sensitivities along a series of curve vectors is generated. The cost of exiting a position is assumed to be 2 basis points at each curve vector (difference in the mid point and bid or ask). So the total delta reserve is 2* Gross DV01. The volatility spread is estimated to be 50% of the 12 month average variance between the MRM (price verification) option valuation, and the Options desk's valuation. These two amounts are added for the bid ask reserve. This process is more closely akin to a price verification procedure than a bid/ask reserve.

Balance guaranty swaps are defined as fixed/floating swaps with an SPE. However these are subject to EITF 02-03 reserves.

Price Testing: ***Satisfactory***

Price verification processes were considered satisfactory and have not changed significantly since the previous year. Difficult to verify positions have not increased in the past year. Limits on aged inventory continues to be an essential element on the control of illiquid positions. For positions not vendor priced, only $300 million is over 30 days old. This constitutes a very tight control.

Finance is responsible for establishing and enforcing corporate accounting policies, P/L generation and reconciliation, aged inventory monitoring and reporting, and market valuation/verification. Finance is independent of the front office. Price verification is conducted bi-monthly for most products although there is no clear summary of which products are included in bi-monthly versus monthly or quarterly verification. A monthly price verification report is produced, discussed with business heads and the CIB Risk and Return Committee. While a process for price disputes is not memorialized in the policy, the transparency of reporting price uncertainties combined with conservative aging practices and served as an effective control. Sources of price verification are approved by finance, MRM, and the business line are documented.

According to the OCC, no vendor pricing is available for 21% of the trading book. This includes loan trading, and variable rate notes. Non vendor sources include matrix pricing. At Wachovia, unlike some institutions, recalculation of model pricing using broker quotes for key inputs is considered to be vendor pricing.

CDS prices are verified two different ways for Credit Products and Structured Products. Investment grade single name CDS are verified by inputs from ValuSpread Credit Data vendor pricing service. For most desks the pricing tolerance is $100,000 or 1% plus $50,000, as the point at which additional trader justification is required. Credit products uses a Price Trend Analysis which requires further explanation for variances over 5% related only to the interest rate products uses on this desk. Only two desks have portfolio thresholds (Equity derivatives and rates)

The price verification policy and procedures is particularly well defined for the CDS, synthetic CDO, and synthetic CDO^2 transactions. This is appropriate given the heavy model reliance and non-observable inputs. Price verification for these trades involves finance independently deriving the implied correlation using the approved model. Finance obtains bid/offer quotes from brokers and calculates the implied correlations based on these quotes. The other pricing inputs include CDS spreads, interest rate swap curve, and recovery rate assumptions. These are easily obtained independently in the market.

Wachovia treats the securitization loan warehouses as AFS portfolios and values them under LOCOM accounting. The value is based on the entire portfolio value in a securitized structure. Middle market loan and commercial real estate finance relies on the front office to do mock securitization, this is compared against securitization parameters for spreads and credit quality, For Middle market loans this is only done when warehouse exceeds $100 million. Front office notifies Finance when credit quality in deteriorating and they discuss remarking.

Rate locks (loan commitments) are considered to be derivatives and the fair value is recorded and marked to market. Rate locks are only valued each quarter due to system limitations (but usually rates do not move enough to cause an impact in one quarter).

CLO's and TRS are independently priced by Loan X. According to the policy, these instruments are not considered important to be accurately priced because the risk is offset by buyers on the other side.

Audit comments note that pricing for HY is very subjective especially when Wachovia is the leader trader of a bond. In these circumstances Wachovia is the entire market. Pricing is reviewed by Finance twice monthly, and there are frequent disagreements over marks. 90% of the desk activity is bonds brought to market by Wachovia and the rest relates to the high yield portfolio held at the holding company. This risk is mitigated by the aged inventory control. A

key aspect of the pricing policy is to monitor closely aged inventory with the philosophy that the older the positions the less reliable the price. Positions are subject to additional mark downs after 90 and 180 days. After 90 days positions are put on a watch list and when sold the realized P/L is compared against the trader mark.

Unlike major competitors, Risk Management rather than finance checks the reasonableness of interest rate curves in Calypso, the books and records system for Rates. They check a matrix of curve points for yesterday and today. Risk Management also reviews the volatilities used in Calypso. This is done mid- month and month-end by checking against multiple dealers and vendors for caps, floors, and swaptions. Monthly, Finance does a "high level" reasonableness test based on short term spot rates and long term swap rates to see direction of change month to month.

Wachovia engages in short dated options trading for both mortgages and treasuries. Finance relies on Risk Management for a "reasonableness check" for inputs which is done twice a month. This process involves two approaches for volatility verification, both are used twice a month. The first uses the OTC options desk model to reprice using volatilities from Goldman Sachs. The second uses a volatility matrix from brokers to interpolate new volatilities for each option

Risk Management discusses the differences with traders. The difference between the trader and market risk calculations for volatilities becomes input to the reserve calculation for bid/ask spreads.

Model Review and Validation: ***Satisfactory***

This control continues to be assessed as "Satisfactory" and has been further strengthened since last year. Improvements include the addition of four new staff members, significant reduction in backlog of validations, and re-writing the validation policy and development of templates for required documentation. In spite of these improvements model validation documentation continues to have gaps between template requirements and actual documentation. Some testing is omitted when use of the model is limited. The OCC has an MRA issued for improvement in documentation.

Model review is the responsibility of MRM and is independent of the model development. This includes documentation of assumptions and full testing. Pricing models may be used on a limited basis by the front office, before complete validation if so approved by MRM. A model used for only one transaction does not need to be in the inventory but still must be reviewed for materiality. The principal derivative system, Calypso, and the commodities booking system Endur both are vendor systems which have regular updates sometimes causing changes to pricing models within the software. These changes have the potential to impact VaR and thus, are included in the validation process.

Model validation is to cover both in-house and vendor developed models. The validation of vendor models must be independent of those making the purchase decision.
The validation policy proscribes procedures as follows:

- All components, input processing and output should be reviewed
- The quality of data inputs should be reviewed unless explicitly assigned to another Wachovia team
- Review should consider the range of inputs for which the model will be used
- Impact of model assumption or approximations should be assessed
- Underlying theory should be reviewed
- Backtesting and calibration should be performed for all statistical models

The validation report and documentation is required to include: the scope, model description, intended use, assessment of inputs, assessment of implementation, description of validation methodology, description of testing, and critical analysis. Based on OCC and FRB examinations, MRM has validated the significant models

A material models inventory is maintained which presents models in easily understood terms, outlining the models purpose and objectives, major assumptions and theories, data inputs, dependence on other models for inputs, and limitations of the model.

According to the Wachovia policy, a model is deemed material if it:

- Has direct and significant impact on books and records
- Directly used in a decision to enter or exit business segments
- Is used to make pricing decisions
- Provides basis for material risk decisions
- Is the source of forecasted financial results related to transactions

Thresholds for materiality are: revenue or expense impact of $10 million whether financial reporting error or P/L. An asset, liability or capital impact of $100 million. Customer impact of 5,000 customers or reputational risk to a few customers.

Outside model validators may be used if MRM is provided with qualifications, validation procedures intended, documentation of validation, and final approval by MRM.

Models are to be reviewed annually to assess continued appropriateness, and should include any changes to the model, or the way it is used, assessment of performance, and changes to inputs. An annual model review report is distributed.

Internal Audit: Satisfactory

Internal Audit continues to be assessed as "Satisfactory" in coverage and quality of reviews. As noted last year, the audit schedule covers the major desks, products, and locations for trading activities. The audits reviewed, showed adequate documentation and elevation of findings, tracking of issues/responses, and reflected sufficient understanding of activity by the audit staff.

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Banking Book

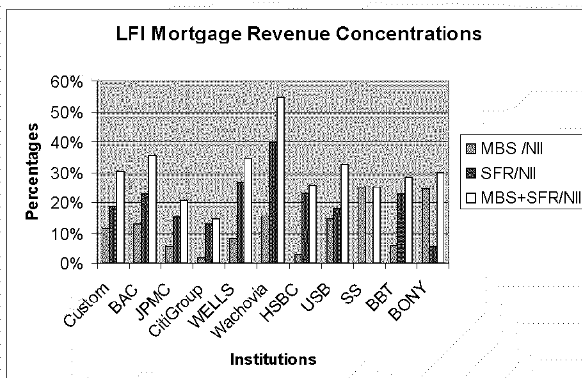
Inherent Risk

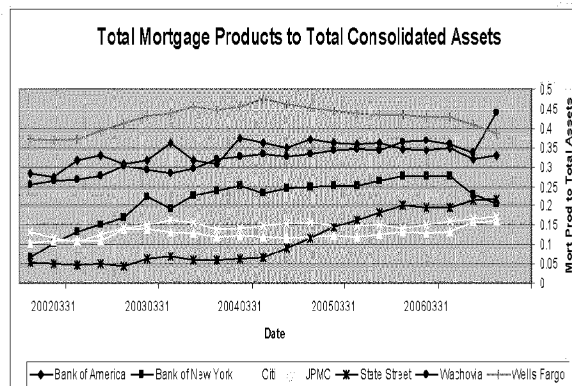
Inherent Market Risk Ratings	Inherent Risk: Market Risk										
	Banking Book				Trading Book						
	Balance Sheet Positioning	Size and Stability of Earnings & Capital	Hedging Effectiveness	Types of Interest Rate Risk	Size of Positions	Liquidity and Complexity of Positions	Strategy and Business Mix	Components of Price Risk	Stability of Earnings & Performance History	Diversification	Position in Market
Subfactor Rating	Mod	Mod	Lim	Mod	Lim	Mod	Mod	Mod	Mod	Con	Mod
Factor Rating	Moderate				Moderate						

Balance Sheet Positioning: *Moderate*

The size and complexity of position exposures to interest rate changes present moderate risk to the company. Wachovia (WB) is a large institution with a complex balance sheet. Although management is effective at hedging this risk, the naked positions would present significant risk. WB has a sizable mortgage-related portfolio that displays considerable prepayment, extension, and convexity risk.

As of May 14, 2007, the AFS portfolio had a total book value of $108.8 billion with an unrealized loss of $843.3 million. Mortgage-related products represented 82.2% of the portfolio, or $89.4 billion, which includes $6.7 billion of Danish MBS. In addition, there are roughly $30 billion in whole loans managed by the Treasury. Clearly, investment mortgage products are contributing substantial interest rate risk. Coupled with the inclusion of GoldenWest and mortgages now represent the majority balance sheet portfolio and revenue generator. Based upon BHCPR data as of December 31, 2006, single-family real estate and MBS revenue comprise 55% of net interest income, well above the closest peer (BAC at 36%). Total mortgage products comprise 44.1% of consolidated assets (Wells at 38.7%). Also contributing to the higher risk profile are the types of mortgages that have been added with GoldenWest, option-ARMs. The nature of these loans presents considerable optionality and makes them difficult to model accurately. GoldenWest modeling has been nominal, with little emphasis from the primary regulator, the OTC. As such, WB management has considerable work to do to incorporate the GoldenWest portfolio properly. While this profile change is reflected in the inherent rating, it is too early to criticize risk management for GoldenWest's failings. Management does recognize the notable increase in mortgage products and has subsequently allowed maturing mortgage investments to roll off with replacement.





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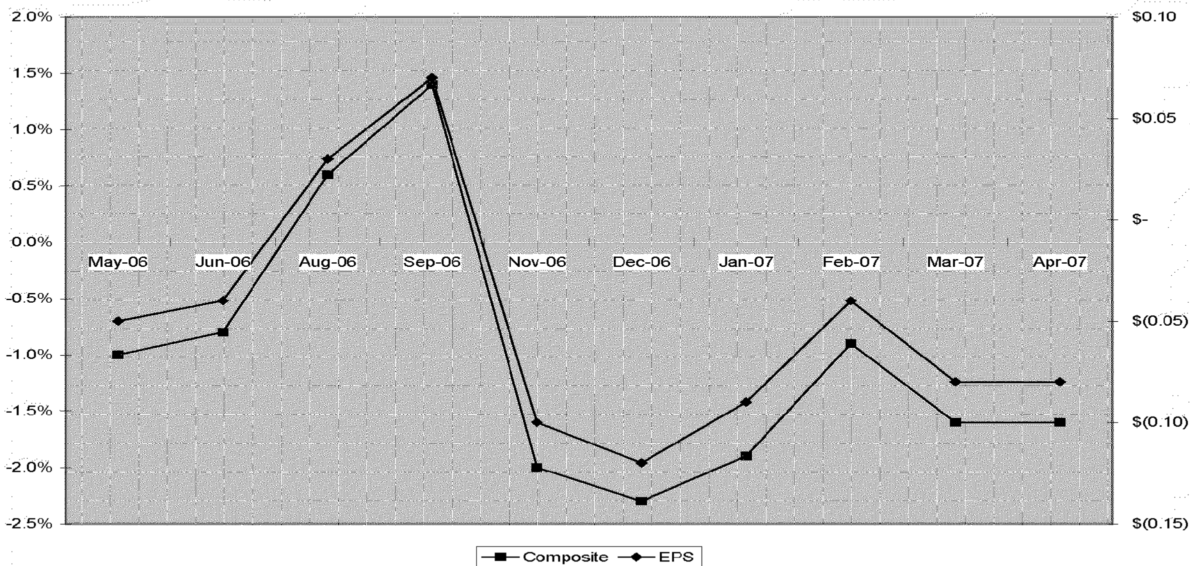
Management has historically taken a conservative approach to interest rate risk management, effectively hedging much of the risk with an occasional opportunistic view on rates. The general strategy has been to produce stable net interest income without incurring excessive interest rate risk. Reviewing net interest margin trends throughout the rate cycle shows management has been fairly successful. As compared to LFI peers, WB has experienced limited variation and maintained a relatively high net interest margin. Meanwhile, the EaR measurement resided within a range of 1.4% to (2.3%) of net income. As depicted in the graph below, the metric spiked toward asset-sensitivity in September 2006 in anticipation of GoldenWest, then subsequently reversed course upon GoldenWest's inclusion.



Although this graph indicates a fairly modest level of IRR exposure, it represents only the sensitivity captured by the composite high rate scenario, which measures just the sensitivity of the policy period (12 months). It does not reflect forward scenarios (described in Risk Measurement), which has shown liability-sensitivity growing to nearly 5.0% (policy limit) into 2008. While management recently executed hedging to reduce this exposure, such projections are a departure from past balance sheet strategies. Management attributed the growing risk profile to the expiration of hedges throughout 2007. Rather than renew those hedges, management chose to wait. Given the exposure to rising rates and management's opinion rates were unlikely to rise, they accepted the growing forward sensitivity until desired hedging opportunities were more affordable.

As of April 2007, the composite measurement projected a 1.6% decline in net income, growing to 4.0% for 2008. The composite is compiled using the market rate curve adjusted for varying spreads between FF and TY10 and then shocked gradually upward 200 bps. The three scenarios reflect an Upward Non-Parallel Shift with 2-Year Rates Less Steepening, Upward Non-Parallel Shift with 2-Year Rates Quickly Steepening, and an Upward Parallel Shift. The most severe of these scenarios would be the parallel shift (inversion continues) leading to a 3.1% decline in net income. A fourth scenario is included in the monthly results, though not in the composite, that is a Downward Non-Parallel Shift with Steepening. This shows 4.0% increase in net income. The table below depicts the results.

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Wachovia Corporation April 2007 Sensitivity Forecast
Excluding Restructuring Charges and Non-recurring Gains

		A	B	C	D	E	F
				Sensitivity			
		$ EPS	Pretax Value of $0.01 EPS	*Scenario 1* *Parallel* *Mkt + 200*	*Scenario 2* *Non-Parallel* *Mkt + 200*	*Scenario 3* *Non-Parallel* *Mkt + 200*	*Scenario 4* *Non-Parallel* *Mkt - 200*
1							
2							
3	Next 12 Months Earnings Forecast	5.11	$29 mm	(0.16)	(0.07)	(0.02)	0.21
4	(Apr 07 to Mar 08)			-3.1%	-1.4%	-0.5%	4.0%
5	Potential $EPS Risk				(0.08)		
6					-1.6%		
7	2008	5.44	$29 mm		(0.22)		
8					-4.0%		

Meeting Date: April 18, 2007

Assumes all maturing loans and securities are reinvested at then prevailing forward rates.

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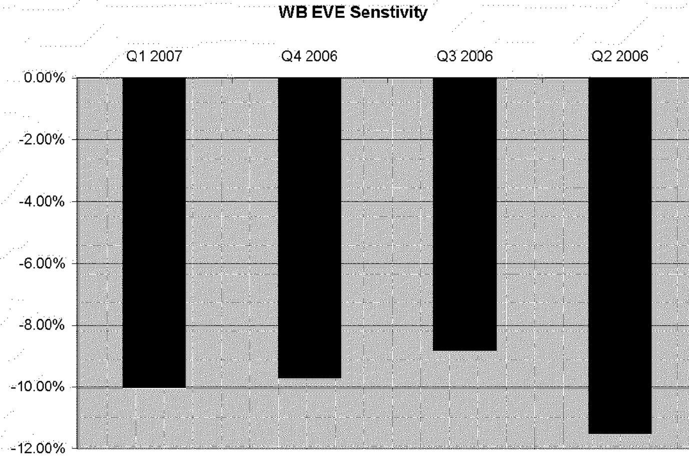
Subsequent to this, management executed hedges to reduce the forward exposure by roughly 140 bps. The scenarios presented above are the common scenarios prepared monthly and used to monitor limit compliance. However, management does prepare additional scenarios, including the aforementioned forward scenarios and other alternative (ad-hoc) scenarios. While there is not currently a flattening scenario prepared for normal presentation, management does complete various inverted scenarios. However, given the current shape of the curve and economic conditions, management does not consider it likely the curve would invert considerably more. Consequently, they choose not to prepare the scenario for ALCO.

Long-term interest rate risk is measured using EVE and is produced quarterly. May 2007 results from EVE indicate a moderate risk posture, 10.0% liability-sensitive in a +200 shock. The overwhelming contributor to this exposure is the preponderance of mortgage assets. The trend through 2006-2007 is shown in the adjacent chart. As shown, EVE sensitivity was fairly stable throughout the prior year ranging from 8.8% to 11.5% of liability-sensitivity. Of note, 2Q06 and 3Q06 do not include GoldenWest. The considerable reduction for 3Q06 is due to a large investment portfolio selloff. GoldenWest reduced long-term sensitivity slightly.

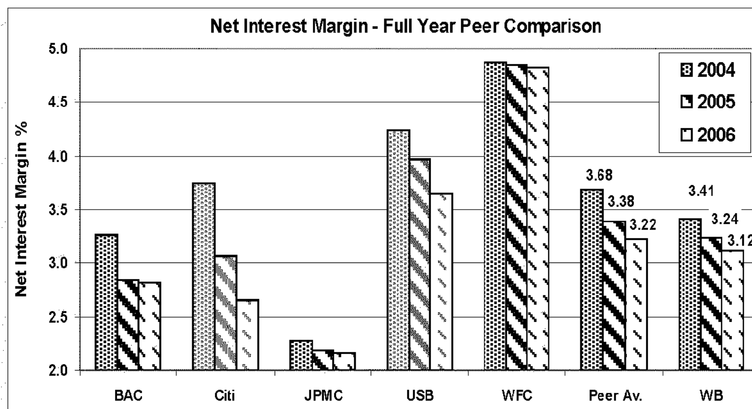


Size and Stability of Earnings and Capital: ***Moderate***

Interest sensitive earnings are considerable with respect to total revenues at 80.3% for 1Q07. Nonetheless, WB has fared well with respect to net interest margin deterioration in spite of the flat/inverted yield curve. Clearly net interest income has suffered, but as compared to LFI peers, only WF has maintained a higher net interest margin. This speaks to management's success in providing stable net interest income without undue interest rate risk. All of this was prior to GoldenWest fully impacting earnings, though. As was the case at legacy GoldenWest, the nature of the option-ARM creates more volatility in net interest income. In fact, as of March 31, 2007, the net interest margin fell to 3.0%. Management has discussed with regulators the need to educate both the investor community as well as senior management of this change in interest sensitive earnings management. Initially, volatility in GoldenWest's earnings was attributed to less active and less sophisticated hedging techniques.

Margin Performance

	Average Net Interest Margin, Past 5 Years	Average Net Interest Margin, Past 3 Years	Average Net Interest Margin, Past 2 Years
Bank of America	3.07	2.87	2.78
Bank of New York	2.20	1.95	2.07
Citigroup	3.69	3.25	2.89
JPMC	1.90	1.92	1.96
State Street	1.21	1.08	1.10
Wachovia	3.54	3.29	3.21
Wells Fargo	4.99	4.77	4.76



Management is now finding it difficult to find effective hedging mechanisms and recently presented this to ALCO. While ALM does admit there is an expectancy to replace any earnings shortfalls, they insist it would not be through

ramping up credit or market risk. Going forward, it will be important to monitor management's willingness to swallow earnings volatility.

Hedging Effectiveness: ***Limited***

Management's IRR strategy is heavily dependant on active hedging, as seen recently in the forward scenarios when hedging was not replaced. To attenuate this risk, management generally uses fairly simple, liquid instruments or strategies such as caps, shorts, and swaps. As noted above, the GoldenWest portfolio presents considerable risk for which management has yet to find an effective hedge. This may lead to more complex strategies should the earnings volatility be unacceptable. All hedging is discussed with ALCO and/or senior management to fully educate them on the risk and earnings impacts. In fact, a recent presentation illustrated the differences between on-balance sheet hedging (historical strategy) and off-balance sheet hedging (current strategy). Management highlighted the earnings relief in the current strategy while still mitigating the risk.

Types of IRR: ***Moderate***

Wachovia generally has moderate exposures to the various types of IRR, including repricing, basis, yield curve, and options risk. Repricing risk, as indicated in the discussion of earnings stability, is moderate, though appears to be increasing with the impact of GoldenWest. Although Wachovia suffered margin compression over the recent rate cycle, they have performed well in comparison with peer companies. Deposit elasticity has helped cushion earnings through the rate cycles.

Basis risk is moderate given the various scenarios modeled in the analysis. The largest basis risk exists between prime-based and fed funds-based products. The GoldenWest portfolio now provides additional basis risk. While the entire portfolio, both assets and liabilities, is essentially variable-rate, the products are priced off different indices, creating roughly a six month lag in repricing when rates move. Management has created a WB COSI that better mirrors the loan portfolio, but there will likely remain some basis risk. Modeling the GoldenWest option-ARMs will require a change to the BancWare system. Management will continue to use the existing GoldenWest model and assumptions until a modification can be programmed by BancWare.

Management periodically completes a basis risk analysis that immediately shocks current rates up 25, 50, 75, and 100 basis points for each type of index used (fed funds, prime, various Libor tenors, and various Treasury tenors). The impact of the change is estimated over various time periods, the longest being over 12 months. This analysis is beneficial in isolating changes and assessing a worst-case scenario, as well as identifying which types of assets and liabilities are most affected by repricing of specific indexes. However, more frequency in running these scenarios is needed.

Yield curve risk is captured in ongoing scenario analysis. Along with the primary scenarios included monthly in ALCO, ALM runs various other scenarios that incorporate various yield curve shifts and shapes. In determining the primary scenarios, management takes a view on the current shape of the curve, the implied forward curve, and the most likely curve scenarios one-year out. Consequently, given the current shape of the curve, flattening scenarios are limited, with management focusing more on steepening curves.

Options risk is considerable given the preponderance of mortgage assets on the balance sheet. Based on different rate cycles, WB can be exposed to significant convexity or prepayment risk. Now with the GoldenWest portfolio, even greater risk is posed by the relative lack of proper modeling at GoldenWest. The legacy GoldenWest model does handle the option-ARM product effectively, but there has been limited use of this model and significant work will be required to bring the BW model up to speed.

Banking Book Risk Management and Controls

Banking Book Market Risk Management and Controls	Risk Management and Controls								
	Board and Senior Management Oversight			Policies & Procedures		MIS and Risk Monitoring		Internal Controls and Audits	
	Board Governance Structure & Oversight	Management Governance and Oversight	New Product/Service Introduction	Policies & Procedures	Limits & Guidelines	Risk Measurement	Management Reporting & MIS	Model Review & Validation	Internal Audit
Individual Factor Ratings	Sat	Sat	Sat	Sat	Sat	Sat	Sat	**Fr**	Sat
Overall Rating	Satisfactory			Satisfactory		Satisfactory		Satisfactory	

Risk management practices are satisfactory. The most prominent change over the last year is the successful implementation of BancWare for Earnings-at-Risk. Economic Value of Equity implementation is scheduled for Summer/Fall of 2007, but does not face the same limitations of RADAR that the Earnings-at-Risk model faced. BancWare has eliminated the manual system workarounds present as part of RADAR and has improved production capabilities. Management is now working on a dashboard that will help identify trends and key drivers of risk. The GoldenWest loan portfolio does present modeling issues. Consequently, it is modeled on the legacy GoldenWest model, BankMaster, and added to BancWare's production.

Interest rate risk is managed by a knowledgeable staff with proper oversight by senior management of Treasury. MIS satisfactorily presents key risk exposures, but continues to be enhanced. Additionally, an effective limit structure is outlined in the policy. Management regularly discusses model results in several forums and recent reporting changes evidence an engaged senior management team. Model validation is deficient and requires improved communication between the Model Validation Group and Asset/Liability Management. Staffing needs also contribute to model validation concerns.

Board and Senior Management Oversight

Board Governance, Structure, and Oversight: ***Satisfactory***

The current Board of Directors is an eighteen member group of experienced and individually successful bankers, business owners, and managers with numerous outside interests. The president of the bank is also the Chairman of the Board. The broad diversity of Board membership adds a high degree of business expertise and acumen to the leadership. The Board uses two main committees to oversee corporate risks, the Audit Committee and Risk Committee (f/k/a/ Credit and Finance Committee). These two groups meet bi-monthly to discuss the highest risks facing the company. The Board is viewed as capable, appropriately engaged in the management of the company, and responsive to regulatory issues.

The Board has delegated oversight of the interest rate risk function to several committees, with responsibilities narrowing down the hierarchy. The Board's Risk policy delegates oversight to the Risk Committee (RC) of the Board, which is comprised of three non-management directors, and which further delegates risk oversight to the Senior Risk Committee (SRC) consisting of senior management. SRC oversees the risk governance structure for all risks (including market and consequently interest rate), monitors the direction and trend of risks relative to business strategies and market conditions, and directs operational actions. The Board designates primary oversight of the interest rate risk function to the Asset/Liability Committee (ALCO).

Reports presented to the SRC and RC do not require the detail presented in ALCO reports, but do profile the risk exposure of the company to facilitate discussion among the highest levels of management. Limits and trends are reported. Discussions at these meetings demonstrate an engaged directorate knowledgeable enough to pinpoint key issues and drivers of key risks. Policies approved by the Board address the significant risk areas and assign responsibility of daily oversight to appropriate management.

Senior Management Governance, Structure, and Oversight: ***Satisfactory***

Senior management adequately oversees IRR. The function is administered by a knowledgeable, though historically lean staff that is highly attuned to the daily supervision and effectively manages the risk. As discussed above, ALCO is delegated with primary responsibility for IRR. ALCO comprises members from each division of Treasury, as well as representatives from WB's business groups and risk management. Meetings are held monthly with CFO Tom Wurtz as Chairman. ALCO serves as the primary committee for IRR, as opposed to liquidity and the Liquidity and Capital Planning Committee. The head of Asset and Liability Management (ALM) meets monthly with ALCO to present the current EAR or EVE analysis. ALCO discussions are comprehensive and draw the attention of senior management.

Under the purview of ALCO is the Treasury Committee, a similar makeup to ALCO, but consisting more of staff with direct responsibilities over Treasury functions. Generally, the Treasury Committee meets semi-monthly. Discussions are more detailed in nature as opposed to ALCO, but consist of similar discussion items. ALM's head participates on Treasury Committee, as well as the Liquidity and Liability Management Committee and New Product Committee. This helps ensure all risks are incorporated into the IRR analysis.

Treasury Risk Management (RM) represents a clear independence from the business units. Influence is adequate and the stature and responsibilities are improving. RM still serves as a facilitator between regulators and audit with the business function. They work with Compliance to ensure limits are met and reported appropriately. When deficiencies are noted by regulators or internal audit, RM works with the business function to address those deficiencies in a timely fashion. RM is also instrumental in facilitating the Treasury and New Product Committees.

Day-to-day supervision of interest rate risk is adequate. Staff is experienced and capable and reporting to senior management is sufficient. Staffing levels have been lean over the last few years in ALM, even as they have implemented the BancWare system. Although management has increased staff, the group still struggles to complete its daily assignments with the added responsibilities of implementing BancWare for EVE and being tasked with other special projects. Management continues to assure regulators that upon completion of the implementation, current staff levels will suffice for daily activities. Nevertheless, we continue to press management to assess staffing adequacy. Management does hope to retain the Treasury Forecasting staff from GoldenWest, especially given their familiarity with GoldenWest's portfolio and risk characteristics.

The BancWare model has been implemented for EaR with the EVE implementation set for late summer 2007. When queried about the delay in EVE, management commented that the deficiencies in the EaR process were not evident for EVE, namely accounting functionality. Consequently, management has not been pressed to replace RADAR for EVE. While BancWare is the primary motor in producing EaR, management uses several systems in attaining values for EVE, BlackRock for optionality and mortgage products, RADAR/BancWare for non-option items such as deposits, and Calypso for derivatives. Now with the addition of GoldenWest, they are using the legacy BankMaster model as WB has no current model that can handle option-ARMs appropriately.

Management has been responsive to audit and regulatory concerns, working to address prior criticisms in project management and controls. In fact, there are currently no open audit issues. In spite of management's efforts, however, regulatory criticisms remain regarding project management and documentation. Project management weaknesses are not limited to IRR, as comments have permeated Treasury examinations over the past two years. In response, a Treasury Project Management Office (TPMO) has been established. However, the TPMO remains in its infancy and is still finding its footing. As such, breakdowns have occurred in model validation. Management and the TPMO are working together now to build checklists and communication channels to ensure this is remediated.

New Product Approval: ***Satisfactory***

The New Product Committee has now been active for over a year after previously being ignored for a year. As stated in the 2006 RAP, the impetus behind formalizing the NPC was an anticipated growing volume of new products being developed in Treasury. While there have been several items presented over the past year, including synthetic securitizations and covered bonds, the volume remains relatively low. In an average month, there may be one new product to discuss, if that. NPC minutes do show appropriate discussion of the issues associated with the new products (including IRR when appropriate) as outlined in the new product proposal.

The NPA Charter details membership requirements, duties, authority, and reporting. The charter satisfactorily addresses regulatory guidance. Standards defining a new product are clearly written and status reports are expected. Minutes do not reflect any updates over the prior year, though updates are often provided in other committee meetings, such as Treasury, Liquidity, or ALCO, which have similar audiences.

Policies, Procedures, and Limits

Policies and Procedures: ***Satisfactory***

Interest rate risk is governed by the Balance Sheet Management Guidelines (Guidelines), last updated December 2006. Roles, responsibilities, and reporting lines are clearly outlined in the policy. ALCO is designated with "responsibility for managing the interest rate sensitivity of the Corporation, but selective limits have been further delegated to specific individuals within the Treasury Group to allow for action if conditions warrant. ALCO will be informed as soon as possible after any of the limits are utilized."

Balance Sheet Management (BSM) is the group assigned responsibility to analyze and execute ALM transactions. Appropriately, BSM reports on earnings forecasts, rate sensitivity analysis, and limit exceptions to ALCO. Within this construct is ALM, who is responsible for daily operation of the model, assumptions, and analysis of output.

The Guidelines discuss major risks and regular reports that pertain to those risks. Reports include earnings forecasts and rate sensitivity analysis, unrealized gains/losses in certain financial instruments, available-for-sale unrealized gains/losses, summary of recent portfolio transactions, sensitivity hedging updates, and portfolio summaries. Distribution of those reports is specifically to ALCO with broader discussion at the SRC level.

The Guidelines do reflect current practice with a large focus on short-term risk (1-year Net Income). While appropriate attention is given to EVE, management puts more emphasis on its EAR measure, given its income focus and more immediate impact. Consequently, EAR is produced monthly while EVE just quarterly.

Limits and Guidelines: ***Satisfactory***

Management has developed limits for both short-term (income simulation) and long-term (economic value of equity) exposure that are reasonable and commensurate with the size and complexity of the institution. They capture all material risks and are approved as part of the Guidelines. The limits do not reflect the full suite of scenario analysis completed by ALM and are broadly written for relevancy in any rate environment.

Short-term sensitivity is monitored using Earnings at Risk analysis over a twelve month period. The limit restricts a negative impact to consolidated net earnings to no greater than 5% over the policy period in a +/- 200 bps shock. The use of Net Income, as opposed to Net Interest Income, is somewhat unusual and could potentially mask interest rate risk. Management's explanation is thus, "Measuring sensitivity of EPS to interest rates puts the risk in the proper perspective to management, shareholders, and investors. It naturally adjusts our $ and % NII sensitivity allowable by policy to the contribution of NII to EPS. We are a changing company, and measuring this way allows us to not have to change our sensitivity policy as we grow or lessen the impact of NII on EPS." Rate movements are ramped off the market forward curve each month to 200 bps over the twelve month period. The market forward rate is constructed using currently implied market forward rate estimates for all points on the yield curve over the next 36 months.

Guidelines were updated to better reflect current practice, a comment made in the 2006 RAP. The standard scenarios, those reported regularly to ALCO, measure "High Rate" sensitivity and "Low Rate" sensitivity. However, since "current market expectations may not reflect a yield curve shape that is consistent with short-term rates rising an additional 200 bps, the "high rate" scenario is a composite using three different yield curve shapes. These yield curves are constructed to represent the likely range of yield curve shapes that may prevail in an environment where short-term rates rise 200 bps above current market expectations. This range will measure the impact of parallel and nonparallel shift in rates on each interest rate scenario." Management has noted that should the rate environment be such that 200 bps rate decreases were unlikely, the same treatment would be considered. In essence, the scenarios are flexible. The limit is not.

Long-term sensitivity is measured using an EVE model. The policy states that EVE measured in a flat rate environment will not decrease by more than 20% for a +/- 200 basis point shock. Current scenarios are run from -100 bps to +300 bps, though policy sensitivity is around the +200 bps shock. As opposed to comments from the 2006 RAP, EVE has been consistently produced quarterly over the past year. Although management gives adequate focus to EVE results, it is not a primary tool for IRR measurement.

Utilization of the short-term limit has remained fairly moderate throughout the prior year, though bouncing around between asset and liability-sensitivity. However, recent forward projections (recalculating current policy period sensitivity in forward quarters) have shown increasing exposures nearing EaR limits (from 4.0% to 4.9%). Management attributes much of this to the expiration of existing hedges, though they recently executed replacement hedges, lowering forward period sensitivity to more modest levels. Management does acknowledge that forward sensitivity is largely dependent on business projections, namely GoldenWest. Depending upon the shape of the curve, option-ARM production changes considerably. This highlights an issue with including growth projections in risk reporting, which can sometimes distort the actual risk exposure. However, management is aware of the business impact and can stratify interest rate risk and business risk.

Long-term utilization has been fairly flat and moderate. The inclusion of GoldenWest slightly reduced exposure to rising rates in 4Q06. Over the past year, EVE sensitivity ranged from around 9.0% to 11.5%, not approaching the 20% limit. Compliance with limits is not only monitored through reporting to ALCO, but also by RM.

Risk Monitoring and Management Information Systems

Risk Measurement (ALM Modeling, Scenario Analysis/Stress Testing): *Satisfactory*

Risk measurement, as noted above, is completed monthly for income simulation and quarterly for EVE. BancWare was implemented this year to use for EaR, but has not yet been completed for EVE (discussed above). With the implementation of BW for EaR, the process is now automated fully within BW. Most of the technical issues that delayed implementation have dissipated, though the model still lacks the production speed initially promised. Consequently, management has yet to reap the full versatility of the model. Production is still much faster than RADAR.

Both the EaR and EVE models adequately capture the material risk exposures. Numerous scenarios are run with varying twists and shocks to model repricing, yield curve, option, and basis risk. However, issues may exist regarding EVE methodology, as calculations are pulled from several sources and no validation has been completed to ensure the methodologies are consistent. For example, most investments and mortgage products are loaded in BlackRock, a recently implemented investment front-office system. The EVE shocks are run in BlackRock and then aggregated with other products in a spreadsheet. Meanwhile, derivatives are sourced from Calypso and non-option products are sourced from RADAR (will be BancWare upon implementation). Given that these models likely use different methodologies to calculate something like duration, the EVE process needs to be validated to ensure the inconsistencies do not present a material issue. Management intends to do this with the Phase II BW implementation.

Nonetheless, assumptions are reasonable and reevaluated regularly. Documentation is spotty and can be improved, another recommendation at the recent examination. Backtests are performed monthly and intended to cover all core assumption and behavior aspects of each balance sheet portfolio. The creation of dashboard has improved this process.

Model validation has been completed for EaR, but remains outstanding for EVE until BW is implemented. It should be noted that project management weaknesses highlighted in the 2006 RAP did contribute to a delayed validation of EaR, though.

Stress testing for both short-term and long-term risk is adequate, though not commensurate with BAC, JPMC, and Citi. While management can speak intelligently about any risk component and regularly completes stresses of various risk types, the scenario analysis provided to ALCO monthly is limited to the standard High Rate and Low Rate scenarios, forward scenarios, and occasional alternative scenarios. This appears to engage ALCO appropriately and present key risk exposures for discussion.

The suite of EaR scenarios changes monthly based upon current rate and economic conditions, but there are standard scenarios that measure the policy period and beyond. Alternative rate scenarios are also frequently run to test sensitivity to specific risks management deems appropriate, such as exposures to curve shapes and basis risk. Admittedly, completion of all scenarios has been intermittent with staff resources stretched to complete other assignments. As noted in the staffing discussion above, management is aware of our concern and assures that upon full implementation of BancWare, staffing levels will be sufficient to meet all ongoing responsibilities. Included below are the standard scenarios, as well as examples of alternative scenarios. Each scenario is developed based upon some shift or twist in the yield curve and are described as such.

Scenario	Description
Market	Market scenario based on current market forwards
MktPriRates	Market scenario from the prior reporting period
MktHighPar1 Scenario 1 Parallel In ALCO Package	Scenario built from the market scenario in which a +200 basis point ramp is introduced in months 2 through 12 of the policy period with the increase of Fed Funds being approximately 18 bps every month of the ramp. The shift in the curve is parallel so that the shape of the curve remains consistent with that of the market at the end of the policy period.
MktHighStand1 Scenario 2, Non-Parallel	Scenario built from the market scenario in which a +200 basis point ramp is introduced in months 2 through 12 of the policy period with the increase of Fed Funds being approximately 18 bps every month of the ramp. This is currently a steepening scenario where we assume the market will react to introduction of Fed action by creating a wider spread between Fed Funds and the long end of the curve in the early part of the policy period in anticipation of further movement. This scenario builds in the market recognition of the Fed's actions slower than MktHighStand2. MktHighPar1 could be interpreted as the market never reacting to the introduced Fed action with anticipation of further tightening.

MktHighStand2 Scenario 3, Non-Parallel	Scenario built from the market scenario in which a +200 basis point ramp is introduced in months 1 through 12 of the next calendar year with the increase of Fed Funds being approximately 18 bps every month of the ramp. This is currently a steepening scenario where we assume the market will react to introduction of Fed action by creating a wider spread between Fed Funds and the long end of the curve in the early part of the policy period in anticipation of further movement. This scenario builds in the market recognition of the Fed's actions faster than MktHighStand1. MktHighPar1 could be interpreted as the market never reacting to the introduced Fed action with anticipation of further tightening.
MktLowStand1 Scenario 4, Non-Parallel	Scenario built from the market scenario in which a -200 basis point ramp is introduced in months 2 through 12 of the policy period with the decrease of Fed Funds being approximately –18 bps every month of the ramp. Because at these current market levels the long end of the curve will be somewhat anchored, we do not feel it is realistic to move the longer points, for example to 10 year rate, down 200 basis points as well. In this scenario we do introduce steepening of the curve over policy period, although all rates on the curve are substantially lowered.
FwdHighM2	This forward scenario always starts the policy period sensitivity measurement in month two of the forecast. This scenario is used to forecast reported sensitivity to a +200 rate ramp in the next reporting period, and thus the policy period is measured starting in month 2. The forward sensitivity scenarios in the standard sensitivity package are run with the same steepening methodology as the MktHighStand1 scenario.
FwdHighY2	This forward scenario always starts the 12 month policy period sensitivity measurement in January of the next year. This scenario is used to forecast reported sensitivity to a +200 rate ramp in the forward policy period. The forward sensitivity scenarios in the standard sensitivity package are run with the same steepening methodology as the MktHighStand1 scenario.
FwdHighQ1	This forward scenario always starts the 12 month policy period sensitivity measurement in the first month of the next calendar quarter after the current policy period (skipping January which is handled with FwdHighY2). This scenario is used to forecast reported sensitivity to a +200 rate ramp in the forward policy period. The forward sensitivity scenarios in the standard sensitivity package are run with the same steepening methodology as the MktHighStand1 scenario.

FwdHighQ2	This forward scenario always starts the 12 month policy period sensitivity measurement in the first month of the 2nd calendar quarter after the current policy period (skipping January which is handled with FwdHighY2). This scenario is used to forecast reported sensitivity to a +200 rate ramp in the forward policy period. The forward sensitivity scenarios in the standard sensitivity package are run with the same steepening methodology as the MktHighStand1 scenario.
FwdHighQ3	This forward scenario always starts the 12 month policy period sensitivity measurement in the first month of the 3rd calendar quarter after the current policy period (skipping January which is handled with FwdHighY2). This scenario is used to forecast reported sensitivity to a +200 rate ramp in the forward policy period. The forward sensitivity scenarios in the standard sensitivity package are run with the same steepening methodology as the MktHighStand1 scenario.
FwdHighQ4	This forward scenario always starts the 12 month policy period sensitivity measurement in the first month of the 4th calendar quarter after the current policy period. This scenario is used to forecast reported sensitivity to a +200 rate ramp in the forward policy period. The forward sensitivity scenarios in the standard sensitivity package are run with the same steepening methodology as the MktHighStand1 scenario.

Alternate Rate Scenarios:

November 2006 Forecast:
Alt1: Market +300 parallel ramp
Alt2: Market – 300 parallel ramp
Alt6: mkt – 25 bps all rates shock month 2
Alt7: mkt – 50 bps all rates shock month 2
Alt8: mkt + 25 bps all rates shock month 2
Alt9: mkt + 50 bps all rates shock month 2

December 2006 Forecast:
Alternate scenarios were run where sensitivity was measured from various baselines where the market was immediately shocked up or down before the ramp.

January 2007 Forecast:
Alt1: flat fed funds, month 2 LIBOR and Treasury spreads constant
Alt2: flat fed funds, wider Treasury spreads and slightly wider LIBOR spreads to funds

Management does note that "typically not all, and frequently not any, alternate rate scenarios are presented in entirety to ALCO. Often their results are discussion points in ALCO, within the ALM team, and other management."

Furthermore, management has identified key risks and selected eight isolated stress tests that they hope to complete on a quarterly basis to capture those risks: changing mortgage prepayment speeds +/-20%; change retention rate of originated mortgages +/20%; change non-maturity deposit elasticity +/-20%; assess impact of DDA growth/attrition of $1B; change fixed rate HELS +/-20%; impact of selling all HEL production; and evaluate shift of renewing option-based commercial loans. Four of the eight stress tests involve products with optionality: mortgage prepayments +/-20%,

and non-maturity deposit elasticity +/- 20%. However, due to time constraints, ALM is not regularly completing these scenarios.

Current EVE scenarios are run from -100 bps to +300 bps, though policy sensitivity is around the +200 bps shock. As opposed to comments from the 2006 RAP, EVE has been consistently produced quarterly over the past year. Although management gives adequate focus to EVE results, it is not a primary tool for IRR measurement and is thus produced quarterly.

Management Reporting and MIS: ***Satisfactory***

As discussed above, management reports capture all material risk, though not all analysis is presented to ALCO, but rather discussed amongst ALM or other management. Discretion is given to ALM to determine the appropriate scenarios and information to present to senior management (ALCO). When compared with peer institutions, such as BAC, WB reports do not provide the level of detail regularly seen in other ALCO packages. For instance, the BAC package presents several steepeners and flatteners of the yield curve, with shocks of both 100 bps and 200 bps. While those scenarios may be run based on current market conditions, they are rarely presented at the ALCO level. ALCO minutes do not reflect the desire for greater information. ALM has noted they present the scenarios they consider most relevant to the institution.

The EaR process is now highly automated, a key change from the 2006 RAP. Through parallel testing during implementation, ALM verified the accuracy of the reports and continues to backtest monthly. EVE, on the other hand, does require manual intervention with the aggregation of various balance sheet portfolios from the various source systems. As discussed above, management intends to verify the appropriateness of this calculation during 3Q07.

Management has modified the presentation of both EaR and EVE throughout the past year to help highlight key drivers of risk and steer discussion of ALCO toward key risk exposures. For instance, with EaR utilization increasing, management began to include graphs explaining the components driving those changes.

Internal Controls and Audit

Model Review/Validation: ***Fair***

The model validation process for the corporation is improved considerably from where it was a couple of years ago, most notably for the CIB. The Model Validation Group (MVG) was established under the purview of CIB's Market Risk Management and is staffed by competent and independent individuals. The basis for the Fair rating is inadequate staffing for the group and the struggle to integrate the model validation process into Treasury. As previously discussed, project management deficiencies led to a delay in validating BW prior to production for EaR, a violation of the Model Validation Policy. While the blame lies partially with ALM for failing to meet the policy, culpability also resides with MVG. Part of their mission is to ensure all key models are validated upon implementation and periodically, thereafter. Communication between the two groups (ALM & MVG) was poor and MVG's lack of staff prevented the EaR model from receiving proper attention. These communication issues have improved, but are not fully resolved and were noted at the recent examination. Both ALM and MVG must work together to ensure that as EVE is rolled into BW, the same issues do not appear. Staffing concerns are being addressed, though regulatory doubt remains as to whether management will properly staff MVG.

Internal Audit: ***Satisfactory***

Internal audit displays the appropriate independence and can adequately assess the interest rate risk function. Members routinely attend monthly regulatory meetings and have consistently engaged management when issues arise, most notably during the BancWare implementation. The competence and stature of audit staff is sufficient.

The Asset-Liability Measurement Audit was issued February 2007, as a follow-up to the 2006 audit that was rated Satisfactory (1 Key Issue, 3 MRAs). The scope of the audit included data collection, development of assumptions and forecast, and analysis and management reporting. The findings from the 2006 audit that were reviewed are noted

below.

Key Issue

- The BancWare conversion is at risk of continued delays due to system limitations, weak project management, and staffing constraints. **(Resolved)**

Matters Requiring Attention

- The process for monitoring and documenting changes in model assumptions needs enhancement. **(Partially resolved)**
- Management review controls require formal documentation. **(Resolved)**
- ALM lacks departmental policies and procedures, specifically guidance on the type and frequency of key controls needed to maintain a stable and satisfactory control environment, as well as desktop procedures that support key processes. **(Partially resolved)**

Audit confirmed that all finding were fully or partially resolved. Although EVE implementation remained outstanding, audit closed the Key Issue because the security and technical weaknesses posed by continuing EaR on RADAR are not present for EVE (similar to management's logic). Thus, there is no immediacy for EVE implementation and no concern around project management. Only one new MRA was found, a "lack of compliance with Corporate Information Security (CIS) standards relating to application authentication and application logging exposes the business to improper modification of data." While we may not consider the BancWare implementation fully resolved, the overall quality and comprehensiveness of audit is adequate.

Liquidity Risk

Inherent liquidity risk is moderate based on the balance sheet activity rating which was increased to moderate. Wachovia benefits from a positive reputation in both the market and retail deposit environment. Funding is primarily driven by a strong deposit base that has proven stable. Management attributes this loyalty to excellent customer service. Funding composition has shifted, though, due to GoldenWest and greater loan demand. Wholesale funding is now more prominent, but management is concentrating on diversifying market sources. Positive debt ratings and strong investor demand have afforded Wachovia favorable pricing. With loan growth projected to outpace deposit growth over the next year, management is forecasting debt issues to remain an important funding source. Besides domestic issuances, management has now initiated offering programs in Europe and Australia and is considering additional markets.

Inherent Risk

Inherent Liquidity Risk Ratings	Inherent Risk: Liquidity Risk							
	Market Access		Business Activities				Corporate Structure	
	Degree of Market Access	Financial Condition	Balance Sheet Composition	Extent and Complexity of Off-Balance Sheet Activity	Securitizations	Payment Processing	Corporate Structure (for domestic institutions)	Head Office Resources (for U.S. branches/agencies)
Subfactor Rating	Lim	Low	Mod	Mod	Lim	Mod	Lim	N/A
Factor Rating	Limited		Moderate				Limited	

<u>**Market Access: Limited**</u>

Degree of Market Access: ***Limited***

WB exhibits good market access through positive debt ratings, a sound reputation, and strong investor demand. Subordinated debt spreads remain at favorable levels due to Wachovia's strong credit profile. Throughout 2006 and 2007, WB has approached the market regularly with a variety of structures, tenors, and currencies. This funding both replaced maturing issuances and represented new funding. Recently, S&P upgraded WB's debt ratings further substantiating WB's strong profile.

Rating Agency	S&P	Moody's	Fitch
Senior Unsecured *Outlook*	AA- *Stable*	Aa3 *Stable*	AA- *Stable*
Subordinated Debt	A+	A1	A+

WB uses both the bank and corporation to access the debt markets. In 2006, the holding company (HC) issued $12.8 billion in long-term debt with an additional $9 billion planned for 2007. Meanwhile the bank issued roughly $20 billion in term debt in 2006. The GoldenWest acquisition prompted much of the HC debt issuance in 2006. Projecting into 2007, management anticipates greater demand for wholesale funding as deposits are outpaced by loan growth. Additionally, the funding of the newly created Irish bank will require greater wholesale funding. While management may tap various funding sources, it is likely market access will be a key component.

Diversification and structure of market funding is satisfactory. Management monitors funding concentrations and has set limits accordingly. To date, the level of unsecured funding concentrations is reasonable and stable. Until 2006, WB had only issued notes domestically. However, to improve diversification, management executed several Euro and Sterling-denominated issuances throughout 2006 and has now completed its first issuance of Aussie Dollar Kangaroo bonds. A Swiss Franc issuance is also being considered. In 4Q05, WB entered into its first borrowing facility

exclusively with international investors. This facility totals $1.5B. Since September 2006, WB established two unsecured back-up lines of credit totaling $5B. WB is also active in the short-term market, most notably fed funds, Eurodollars, repos, and commercial paper.

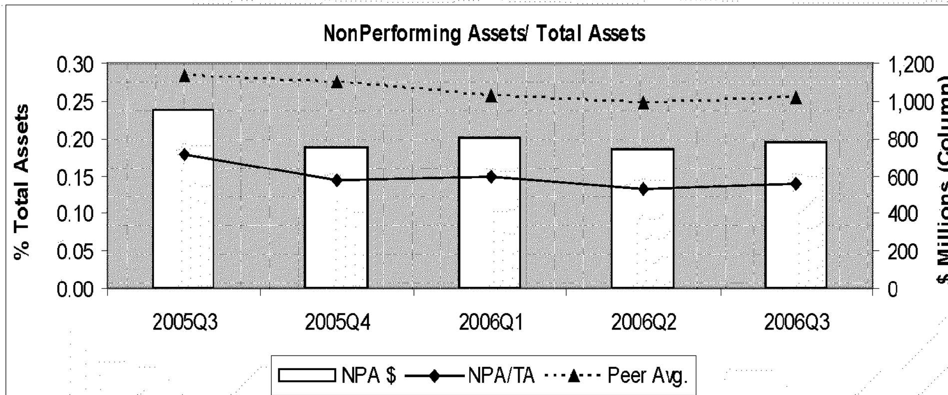
WB has shown limited utilization of its net debit cap. The range of Daily Peak cap utilization for WB is 1%-24% for the period of May 2005 until December 2006. The mean is 8.83%. Among the LFI banks, WB is either the lowest, or tied for the lowest, in Daily Peak utilization rate.

Financial Condition: ***Low***

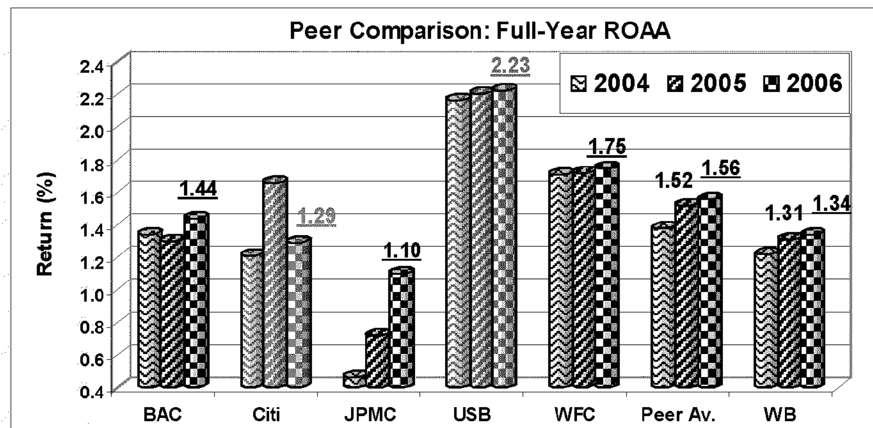
WB is in satisfactory financial condition with no adverse issues identified in capital, asset quality, or earnings performance that would impair liquidity. The strong debt ratings represent the market's favorable view of WB's financial condition. Internal regulatory ratings are :

Financial Performance	**Satisfactory (2)**
Asset Quality	Strong (1)
Earnings	Satisfactory (2)
Capital	Satisfactory (2)

Asset quality metrics have remained strong through year-end 2006 and into 1Q07, with nonperforming assets at just 0.41% of total loans and net charge-offs just 0.15% of average loans. While these metrics have ticked up slightly since a year prior, they are still remarkably low. WB compares favorably to peer in all traditional measures, including NPAs, net charge-offs, classified assets and criticized assets. Modest increases in nonperforming assets due to WestCorp were offset by nominal GoldenWest numbers. Asset quality is driven by disciplined client selection and portfolio management.

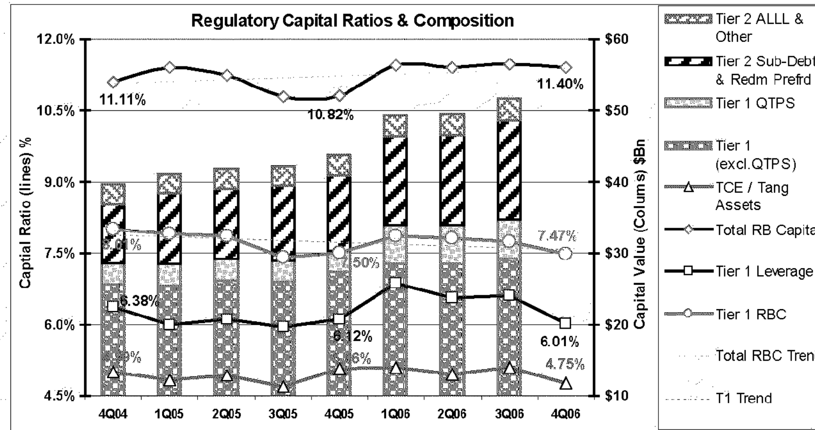


Earnings and Capital were rated satisfactory at the most recent RFI assessment, with sound performance and sufficient capital levels that both lag peer averages. For 2006, net earnings from continued operations rose 20%. Performance did suffer from margin compression and higher than peer expenses, but WB's margin compression was commensurate or better than peer, buoyed by WB's diversified business model. Low provisions also benefited performance. Current forecasts (as of 1Q07) for net interest income are relatively flat, noninterest income with low double digit



growth, and noninterest expense in mid-single digit growth

WB remains well-capitalized with Tier 1, Total, and Leverage ratios of 7.4%, 11.5%, and 6.1%, respectively at 1Q07. However, WB is increasingly dependent on limited core capital and supplementary capital elements. The GoldenWest acquisition reduced capital ratios in the fourth quarter and core capital ratios declined in 2006 and remain below peer. Nonetheless, capital presents no adverse issues that would impair liquidity.



Business Activities: *Moderate*

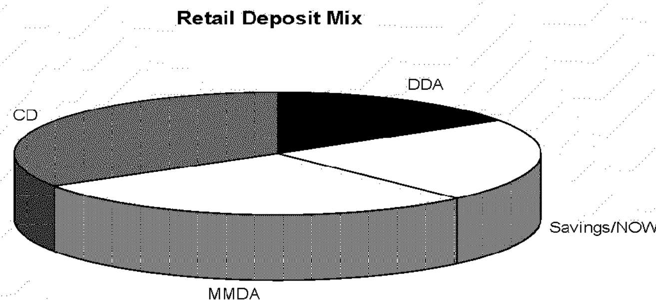
Balance Sheet Composition: ***Moderate***

The balance sheet composition presents moderate risk characterized by a stable and significant deposit base, growing levels of wholesale funds, adequate level of liquid assets, and limited exposure to off-balance sheet commitments. Additionally, the parent company maintains liquid investments sufficient to meet at least 12 months of obligations. Loan growth coupled with the GoldenWest balance sheet has significantly changed the liquidity profile, though can effectively meet funding needs.

WB is a strong proponent of balance sheet liquidity, greatly preferring "retail deposit issuance over wholesale at any given acceptable rate," as noted in the June 2005 Liquidity Committee minutes. Although deposit growth shows considerable gain of 24.2% from 1Q06 to 1Q07, this is largely attributable to the addition of GoldenWest. Prior to the acquisition, deposits had actually fallen slightly. The GoldenWest deposits were primarily CDs as the institution was not run as a traditional bank. Clearly, management intends to establish traditional banking operations at these branches, but it is unclear how quickly this will be successful. Core deposits represent the bulk of total deposits at $377.4 billion, or 53.4% of total assets, roughly static from a year earlier. Management has been able to sustain this level while also managing pricing.

Deposit elasticity has shown to be considerable, based upon stability of deposits and the measured approach with which management has maintained deposit rates. Deposit pricing strategy generally results in WB rates comparing in the middle third in most markets. Management has not felt compelled to meet federal funds rate increases on a 1-to-1 basis, nor always match competitor pricing. Instead they rely on positive customer service metrics that indicate WB is a market leader. WB will competitively price deposits depending on market participants, but finds no need to lead deposit pricing.

The deposit mix is diversified with large core deposits balances in money market, CD, and interest checking deposits. Much of the CD growth over the past year is due to GoldenWest, which had roughly $50 billion in CDs upon acquisition. Demand deposits declined slightly in 1Q07, slightly offset by growth in interest-bearing deposits. Brokered deposits remain a nominal funding source.



Consistent with recent performance, management is only forecasting additional

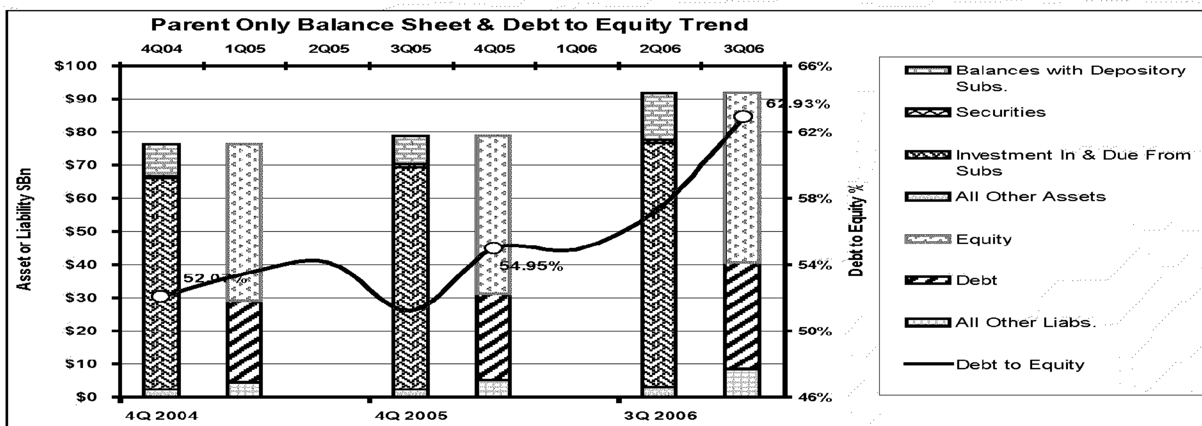
core deposit growth of $12.6 billion through 2007, primarily in 4Q07. Based upon seasonality and market trends, management is anticipating modest declines in deposit levels through the summer. Pricing strategies will vary by region, but are typically in the middle third for each market. With only modest deposit growth, future funding needs remain significant. Current forecasts suggest these needs will be met with term funding, but WB has displayed good market access and favorable pricing.

Loan growth since 1Q06 has consistently outpaced deposit growth, resulting in year-on-year growth of 50.1%, again largely due to GoldenWest. Over that time, the loan-to-deposit ratio has gone from 85.5% to 103.3%. This marks a considerable change from prior periods and speaks not only to the weak deposit growth, but also drift in funding composition. Unsecured borrowings have more than doubled since December 2005, rising from 13.5% to 22.6% of total assets. Comprising this growth are the FHLB borrowings acquired through GoldenWest, increased bank and HC term funding, and short-term borrowings. Initially there was uncertainty whether management would be able to negotiate acceptable agreements with the FHLBs, but both contracts are essentially renegotiated so current funding will not have to be replaced. Management may yet restructure the borrowings, but will not be forced to replace them. Management does prefer retail funding over wholesale at any reasonable cost, but as noted above, prefers not to pay leading market rates, especially when market funding remains affordable.

Management maintains a level of liquid assets sufficient to meet a potential shortfall in cash flow. A policy minimum of $20 billion has been established and as of March 31, 2007, total liquid assets were $57.8 billion, unchanged from a year prior. Although liquid assets represent a smaller percentage of total assets than peer (just 21.8%), the net short-term position is favorable at $3.2 billion. Monthly liquidity reports document total as well as short liquid assets, represented by fed funds, Eurodollar placements, reverse repos, securities borrowed and securities borrowed/matchbook. Short liquid assets represent 21.0% of total liquid assets. Liquidity remains in the investment portfolio as well, as noted by periodic strategic gains. However, with the rise in rates and predominance in MBS, the portfolio exhibits an unrealized loss of $843.3 billion. 52.3% of the portfolio is pledged.

Management monitors contingent liabilities based upon the likelihood they will be funded. Types of commitments include conduits relating to liquidity facilities, unfunded loan commitments, TOB/lower floaters, and CDO, CREF and large loan securitizations/sales. Levels have fallen from 9% of total assets at 1Q06 to just 7% currently.

The parent company provides substantial support to the bank, with over $12 billion of liquid instruments on balance sheet and the ability to meet all maturing debt instruments through at least a twelve month period. As of March 31, 2006, holding company surplus funds (unencumbered O/N investments less CP outstanding and maturities within one year) totaled $1.5 billion. Leverage levels have increased significantly, but debt-to-equity remains well below peer. Cash flow is sufficient to cover fixed charges. Equity investment in subsidiaries represents 123% of equity capital, comparable to the largest peers.



Extent and Complexity of Off-Balance Sheet Activity: ***Moderate***

WB's trading activity, while not on par with investment banks and larger peer companies, is growing. The addition of

GoldenWest reduced the impact of trading activity to the bottom line, but WB is active in most trading arenas. For 1Q07, CIB contributed 18.2% of total revenues. Management continues to expand volume and revenue of most complex products, as well as development of these products. Though traditionally management has targeted more mature markets, they are increasingly interested in more complex and emerging products. However, any impact from collateral calls does not present considerable concern. Management routinely monitors off-balance sheet collateral contingency for end-user and trading activity for Market +150, +300, and -100 scenarios. Loan commitments and ABCP conduits when taken as a percentage of total assets compare favorably to peer.

Ability to Securitize Assets: Limited

WB is active in the securitization market. WB securitizes traditional asset classes such as home equity closed-end and PELS (super prime), mortgages, and auto loans, as well as nontraditional asset classes. The securitization market is sufficiently deep to support additional securitizations, and WB uses its contingency planning process to project potential securitization activity under a variety of scenarios.

Overall, management promotes securitization activities as an efficient use of the balance sheet, capital, and as a good source of fee income. Risk Management and the Treasury Department generally co-selects pools for securitizations based on overall treasury management objectives. Off balance sheet securitizations totaled $12B at December 31, 2006, approximately half of this amount consists of mortgage related products. WB continues to originate PEL loans; however, growth in this product has been nominal in 2006, (just enough to maintain a market presence). No securitizations have recently triggered any early amortization events, nor has any securitization been required to be moved back on-balance sheet during 2005.

Payment Processing: *Moderate*

WB has not yet reached significant participant status as defined by the "Sound Practices Paper." Wholesale and retail electronic payment channel activity is dominated by a few products: wire, ACH and debit card. WB is an active CHIPs user, with 50% of usage coming from international funds transfer activity. WB has the capacity to effectively process all activity, making use of daylight overdrafts, though has never exceeded its net debit cap. Daily peak utilization is among the lowest of LFI institutions, though small increases were attributable to additional funding being provided New York operations. Processes are considered sound with limited human interaction on an exception basis.

Corporate Structure: ***Limited***

Corporate Structure (for domestic institutions): *Limited*

There is limited complexity in the corporate structure. While the institution operates numerous nonbank subsidiaries, most of these legal entities serve as special purpose vehicles or operate under very specific investment guidelines with limited funding requirements. To limit parent company funding requirements, WB consolidates most permissible activities into the bank. The parent company primarily serves as a vehicle to access debt markets and to book ineligible bank assets. Therefore limited activity is conducted outside of the bank, with the exception of broker/dealer, principal investing, and insurance. The broker/dealer is encouraged to self-fund or obtain external funding when possible. Funding is managed centrally out of Corporate Treasury for the parent company (including nonbanks) and the bank.

Liquidity Risk Management and Controls

Risk management practices are satisfactory. A strong and experienced management team has developed comprehensive policies and reports to aid in governance of the liquidity function. Improvement to processes and reporting continue, especially through the Enterprise Funding Initiative (EFI).

Liquidity Risk Management and Controls	Risk Management and Controls								
	Board and Senior Management Oversight			Policies & Procedures		MIS and Risk Monitoring			Internal Controls and Audits
	Board Governance Structure & Oversight	Management Governance and Oversight	New Product Approval	Policies & Procedures	Limits & Guidelines	Risk Measurement	Management Reporting & MIS	Contingency Funding Plan	Internal Audit
Individual Factor Ratings	Str	Str	Sat	Sat	Sat	Sat	Sat	Sat	Sat
Overall Rating	Strong			Sat		Satisfactory			

<u>Board Governance and Senior Management Oversight: *Strong*</u>

Board Governance, Structure, and Oversight: ***Strong***

The current Board of Directors is an eighteen member group of experienced and individually successful bankers, business owners, and managers with numerous outside interests. The president of the bank is also the Chairman of the Board. The broad diversity of Board membership adds a high degree of business expertise and acumen to the leadership. The Board uses two main committees to oversee corporate risks, the Audit Committee and Risk Committee (f/k/a Credit and Finance Committee). These two groups meet bi-monthly to discuss the highest risks facing the company. The Board is viewed as capable, appropriately engaged in the management of the company, and responsive to regulatory issues.

The Board has delegated oversight of the liquidity risk function to several committees, with responsibilities narrowing down the hierarchy. The Board's Risk policy delegates oversight to the Risk Committee (RC) of the Board, comprising three non-management directors, and which further delegates risk oversight to the Senior Risk Committee (SRC) consisting of senior management. SRC oversees the risk governance structure for all risks, monitors the direction and trend of risks relative to business strategies and market conditions, and directs operational actions. The Board designates primary oversight of the liquidity risk function to the Asset/Liability Committee (ALCO).

Reports presented to the SRC and RC do not require the detail presented in ALCO reports, but do profile the risk exposure of the company to facilitate discussion among the highest levels of management. Limits and trends are reported. Discussions at these meetings demonstrate an engaged directorate knowledgeable enough to pinpoint key issues and risk drivers. Policies approved by the Board address the significant risk areas and assign responsibility of daily oversight to appropriate management.

Senior Management Governance, Structure, and Oversight: ***Strong***

Senior management is well-qualified. Management displays significant experience and grasp of the issues facing the institution, along with experience raising wholesale funds in adverse circumstances.

Governance benefits from an active committee structure with the Asset/Liability Committee (ALCO) serving as the primary forum to discuss activities and risks associated with funding. ALCO comprises members from each division of

Treasury, as well as representatives from WB's business groups and risk management. Meetings are held monthly with the CFO Tom Wurtz as Chairman. Common discussion topics include investment portfolio activity, liquidity, interest rate sensitivity, and securitization activity.

Under the purview of ALCO is the Treasury Committee, a similar makeup to ALCO, but consisting more of staff with direct responsibilities over Treasury functions. Generally, the Treasury Committee meets semi-monthly. Discussions are more detailed in nature than ALCO, but focus on similar topics.

Also reporting through ALCO is the Liquidity and Capital Committee, which meets monthly and consists of all relevant liquidity personnel, as well as the Corporate Treasurer, investment portfolio head, a senior member of Asset & Liability Management, and Risk Management. The Committee charter was amended in 2006 to formally include capital. Also reporting through ALCO is the New Product Committee (NPC).

Senior management has shown a commitment to continually improve processes and reporting. As part of the EFI, parent company governance was consolidated under Corporate Funding to ensure a consistent corporate strategy. Although the EFI progressed little during 2006, this was primarily due to the absence of the Head of Funding, who was injured in a car accident. Upon his return, the EFI has gained considerable traction and management has provided a detailed project plan to regulators.

In spite of the limited progress on EFI, management has developed more structure to ensure they are knowledgeable of all liquidity risks within the company. For example, a Debt Committee was formalized in 2006 that facilitates discussion amongst the lines of business and corporate funding for all market funding activities. CIB does have the ability to access the market, but is restricted by limits and must first run such activities through the Debt Committee. Additionally, while London and Hong Kong have separate liquidity policies, there is regular discussion with the corporate function and the expectation that should liquidity be needed, it first go through Charlotte.

Risk Management is active in all Treasury committees with the Balance Sheet Management (BSM) Risk Manager acting as Secretary for most. They exhibit the appropriate influence on controls and business line activities. Management has been responsive to both audit and regulatory concerns.

New Product Approval: ***Satisfactory***

The New Product Committee has now been active for over a year after previously being ignored for a year. As stated in the 2006 RAP, the impetus behind formalizing the NPC was an anticipated growing volume of new products being developed in Treasury. While there have been several items presented over the past year, including synthetic securitizations and covered bonds, the volume remains relatively low. In an average month, there may be one new product to discuss, if that. NPC minutes do show appropriate discussion of the issues associated with the new products (including liquidity when appropriate) as outlined in the new product proposal. Incorporation into the contingency funding plan is not explicit in the proposal, but is relevant and considered depending on the type of product.

The NPA Charter details membership requirements, duties, authority, and reporting. The charter satisfactorily addresses regulatory guidance. Standards defining a new product are clearly written and status reports are expected. Minutes do not reflect any updates over the prior year, though updates are often provided in other committee meetings, such as Treasury, Liquidity, or ALCO, which have similar audiences.

Policies, Procedures, and Limits: ***Satisfactory***

Policies and Procedure: ***Satisfactory***

The liquidity function is governed by the Balance Sheet Management Guidelines (Guidelines). The Guidelines are comprehensive, setting limits and procedures for both the bank and parent company. Policies are maintained to reflect the current risk profile of the company and limits are generally considered appropriate. The Guidelines were last approved December 2006, but were recently amended to reflect changes in the risk profile and asset size. Specific risk factors discussed in the Guidelines include internal and external liquidity sources, funding requirements, off-balance

sheet liquidity exposure, exposure to specific funding sources by investor and product, overnight funding reliance, and liquid assets. Management responsibilities are also discussed in the Guidelines. These responsibilities pertain not just to daily management of liquidity, but also contingency funding events. Separate policies are maintained for the Hong Kong and London branches.

Limits and Guidelines: ***Satisfactory***

Senior management has established comprehensive limits commensurate with the size and complexity of the institution. Limits are set across a broad range of liquidity risk factors, as described above. Many of those limits are presented in hard dollar amounts. However, management's use of absolute dollar amounts instead of ratios presents concerns for a growing company. They can become outdated quickly, do not provide useful trend analysis, and limit peer comparisons. Management does address the use of hard dollar limits in the Guidelines: "Most guideline minimums and maximums are stated as dollar amounts rather than ratios to facilitate daily management; however, these amounts are appropriately influenced by their relationship to the company's asset size as well as by market and other pertinent factors. Management will remain attuned to changes in the company's size and other factors and will recommend guideline changes to ALCO when appropriate." Furthermore, management also understands a percentage number would require better systems than currently available, with real-time capabilities, to be fully effective. The execution of the EFI should assist in this matter. Minutes do reflect discussion of limits and their appropriateness given changes in asset size. Parent company limits are also included in the Guidelines.

Treasury is responsible for monitoring compliance with policy limits and reporting to ALCO when a limit is breached to be accompanied with an action plan to bring the limit back into compliance. While the Guidelines set hard limits, there are instances where Liquidity and Liability Management have set guidelines as well, which serve as a soft limit. One such limit is overnight borrowings. While the official limit is $25 billion, a guideline has been established at $20 billion that would initiate long-term debt issuance. A sample of limits follows:

- Overnight Borrowing Limit $25 billion

- Minimum Liquidity Surplus (Billions)

Scenario	One	Two	Three	Four
30 Days	$25	$15	$5	$3
90 Days	$25	$15	$8	$6
180 Days	$25	$15	$8	$6

- Liquid Assets (Guideline Minimum) $20 billion

- By Product Type

Maximums ($Mil):

Scenario:	One	Two	Three	Four
Overnight Fed Funds & Euros*	25,000	17,500	5,000	2,000
Term Fed Funds & Euros	15,000	10,000	7,500	5,000
WB Corp Comm Paper	12,000	6,000	2,500	1,000
National Market CDs Under 1 Year 1 Year and Longer	 15,000 40,000	 10,000 40,000	 5,000 30,000	 3,000 25,000

Deposit Notes/Bank Notes Under 1 Year 1 Year and Longer	15,000 60,000	10,000 60,000	4,000 50,000	1,000 25,000
Total	178,000	151,500	103,500	62,000
Overnight Fed Funds & Euros Plus O/N Nat'l Mkt Comm Paper*	25,000	17,500	5,000	2,000

Additionally, parent company limits include a Net Short-Term Position (liquid resources shall be greater than potential cash calls), a Cash Capital Position (long-term funding shall be greater than illiquid assets), a SEC 3(a)(iii) Requirement (Eligible uses of commercial paper shall be greater than the total amount of commercial paper issued) and Double Leverage (≤130%). The Net Short-Term Position essentially ensures the company can meet all debt obligations within the next twelve months and is the most commonly cited measure.

Risk Monitoring and Management Information Systems: Satisfactory

Measurement/Risk Assessment Approaches: ***Satisfactory***

Liquidity risk metrics present the material components of risk to senior management. Primary metrics focus on overnight funding reliance, purchased funds outstanding, contingent liquidity exposure, and projected cash flows. Monthly and quarterly reporting provides management with both snapshots and trend analysis for retail and wholesale funding, including securitizations, commercial paper, and debt issuances. Additionally, forecasts are constructed for both the bank and parent company.

Quarterly, management produces contingency funding analysis, using four stress scenarios that increase in severity and are tied to the company's debt ratings. Incorporated into the scenarios are Securitization, Sale, and Financing Potential, Estimated Cash Flow for Contingent Liquidity Items, Retail Deposit Runoff Estimates, and Asset Mitigation Items. Liquidation values of most assets appear reasonable with appropriate haircuts assigned. The detail of these assumptions is included in the quarterly liquidity report.

Management Reporting and MIS: ***Satisfactory***

As alluded to above, monthly and quarterly liquidity metrics present the material components of risk to senior management. Liquidity information is presented at several committees, including the Liquidity and Capital Planning Committee, Treasury Committee, ALCO, and the Senior Risk Committee. Additionally, management has reports that assist in daily liquidity management.
While the bank's monthly and quarterly liquidity reporting is highly automated, daily monitoring and reporting is less structured and remains manually intensive. However, management is developing an internal solution to automate daily liquidity management as part of the EFI.

Reports are produced with ample frequency for the criticality of the information. Monthly liquidity reports include the following:

- Purchased funds outstanding/Contingent Liquidity Exposure
- Projected O/N and Non-O/N funding needs
- Consolidated Liquidity Projection for 12 months
- O/N borrowings trend
- Wholesale rates, securitization activity, and forecasted deposit, equity and loan balances
- Large Funds Providers

Quarterly reports provide the same information, with the addition of contingency analysis, core deposit runoff estimates, and short-term trend analysis. These reports are produced with direct feeds from automated systems. Manual intervention in the daily reporting is required due to the constant activity and changing balances. Controls are largely in place to ensure data integrity, but occasional communication breakdowns have led to overdrafts with the Federal Reserve. Management anticipates the implementation of the Enterprise Funding Initiative will improve daily liquidity monitoring and overall communication.

Contingency Funding Plan: ***Satisfactory***

Robust contingency stress analysis is performed quarterly at the bank level. The Guidelines thoroughly outline the responsibilities and action steps for key individuals at various stages of a stress scenario, fully integrating it into the ALCO process. However, the parent company was cited at a 1Q05 parent company inspection for deficient contingency planning, both for analysis and identification of key roles and responsibilities. Management has addressed many of these concerns and will continue to improve parent contingency funding through the EFI. As of 1Q07, the parent company is now included in quarterly contingency analysis. However, management is working to include parent subsidiaries by summer 2007.

WB's core stress testing involves four scenarios, each tied to downgrades in WB's credit rating. There is no discussion of the cause of the downgrade, though this may affect the availability of certain funding. A surplus is required in each scenario. Limits have been set under each scenario and time frame, and sufficient detail and a succinct summary report as well as historic trend are reported regularly. A commercial paper (CP) issuance disruption scenario is included in the results of the four scenarios where the various conduits that fund via CP cannot issue while there are also draws on WB-issued CP backup lines to other issuers. This impact is estimated over six months.

Asset mitigation and retail deposit runoff estimates are included. It should be noted the deposit runoff estimates were originally created using historical analysis provided by the OCC with slight modifications to reflect WB practices. The asset mitigation projections are based on analysis done by management and incorporate estimates given by the Lines of Business.

Management continues to improve their securitization estimates and has designed a reasonable analysis. For their worst case scenario, the methodology looks at the widest ABS spreads during periods of economic crisis (4 standard deviations at 10/98) and increases the spread to 6 standard deviations to account for the possibility of WB suffering company specific negative news while at the same time being in a poor market. A similar methodology and increased haircut is used for their second to worst-case scenario.

Much of this analysis is quantitative, based specifically on the results of the scenarios. WB has consistently exceeded the minimums for these scenarios so there has been little discussion in committee minutes. Contingency analysis continuously goes through modifications. In the last year, management has included the parent company and extended scenario analysis out to one year. Contingency analysis is administered at a corporate level and is not addressed within the Lines of Business.

Internal Controls and Audits: ***Satisfactory***

Internal Audit: ***Satisfactory***

Internal audit provides sound support to the company. Technical expertise is sufficient to assess liquidity risk management and Audit demonstrates appropriate independence. Audit's stature garners timely responses to identified weaknesses. Members from Audit attend quarterly regulator meetings and routinely engage members from the Funding group should a question arise.

Liquidity is considered a Medium Risk Audit entity, meaning it is reviewed every two years. The most recent Liquidity audit was completed in 3Q05 and rated "Satisfactory". The scope of the audit was to "evaluate the design and test the operating effectiveness of internal controls within the LLM (Liquidity and Liability Management) and Bank Funding business units". It included a review of the CFP, pricing procedures, Fed Account and Clearing Balance maintenance,

issuance of long-term debt, and guideline approval and compliance.

Only one MRA was noted, a manually intensive and untimely process for monitoring funding concentrations and positions versus limits. Specifically, it related to the Large Funds Provider report. The issue currently shows as Management Closed on the Audit Database and will be verified at the next audit scheduled for fall 2007.

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Operational Risk

Inherent Risk

Inherent operational risk at the company is considerable. While some risk exposures, most notably information security, have stabilized to a degree, challenges remain. Additionally, the assessment reflects the heightened execution risk exposure from the growing size and complexity of the company's operations and product offerings, coupled with its dependency on a technology environment that provides ongoing challenges. That said, over the past year the company has demonstrated satisfactory information technology (IT) production stability with only occasional issues noted. Additionally, there is adequate capacity to ensure daily production of all major processes and system response times have been strong. Disaster recovery testing conducted in the past year was successfully completed, and pandemic planning is progressing. To ensure ongoing improvement, various projects are underway to advance the efficiency of the underlying infrastructure.

While some lessening of the risk profile is noted, Wachovia does, however, continue to face challenges and some legacy operational risk issues remain a key supervisory concern. The leading risk exposure is the proximity risk related to the company's two data centers in Winston-Salem, North Carolina. The new Oxmoor facility in Birmingham, Alabama was completed in June 2006. A three-to-four year plan is underway to move a significant portion of the production processing to that facility by late 2009. With one exception, risk remediation efforts aimed at addressing the long-standing CIS issues were generally complete at year-end 2006. However, while acknowledging the improvements in the control environment, work remains and the remedies are not yet seasoned and proven sustainable. Further complications stem from the technology environment which consists of a disparate portfolio of technology infrastructures, applications, and reporting systems. This situation is a product of years of mergers, acquisitions and wide-ranging business line technology deployments. While significant progress was made on some remediation issues, additional business line specific infrastructure improvements are still needed, such as the extensive technology infrastructure and applications simplification work that is part of a three-year project in CIB.

The company is continuing an aggressive offshoring/outsourcing program that will see FTEs grow from approximately 700 in December 2006 to nearly 2,100 by year end 2007 and management is looking for opportunities to offshore complete (end-to-end) business processes starting in 2008. Additional vendor reliance is being placed on a third-party service provider supporting the strategic growth initiatives in London. With the offshoring of applications and business processes comes delegation of critical controls to third-parties domiciled in foreign sovereignties.

Management has historically operated as a market follower for new or changing products or services. However, recent strategic acquisitions and the decision to reenter the credit card market have introduced higher volumes and product processing requirements to which management is not experienced, heightening risk exposure. Management is also exploring new service delivery channels, most notably the desire to become a leader in mobile banking capabilities. Finally, although Wachovia is not a key player in the critical payments markets, the increasing volume and nature of transactions adds complexity as the company's presence in the national payments system becomes increasingly prominent.

Inherent Operational Risk -- Considerable

Inherent Operational Risk Ratings	Inherent Risk: Operational Risk																					
	People								Process									Systems				
	Internal & External Fraud				Employment Practices and Workplace Safety				Clients, Products & Business Practices				Execution, Delivery & Process Management					Business Disruption & Business Failures				Systemic
	Complexity of financial instruments, services, or processes	Complexity of governance structures	Degree of human interaction / intervention in transactions	Counterparty transparency	Employee competence	Key Person Risk	Staffing Levels	Staffing Turnover	New or Changing Products or Services	Annual Growth (on and off-balance sheet), Consolidation or *De novo*	Market Competition	Outsourcing / Offshoring	Products and Services complexity	Straight through processing	Volumes	Monetary Value	Systems Conversions / Integrations	Technological Complexity	Level of systems and business line interdependence	Geographic Diversity – Information Technology / Operations	Participation in Payments and Settlement Systems	Systemic Payments Risk
Subfactor Rating	Mod	Lim	Mod	Lim	Lim	Lim	Lo	Lim	Lim	Con	Con	Con	Mod	Mod	Lim	Mod	Con	Con	Mod	[illegible]	Lo	Lim
Factor Rating	Limited								Considerable									Considerable				

People - Limited

Internal & External Fraud

Complexity of financial instruments, services or processes: Moderate

Wachovia Corporation (Wachovia) is the fourth-largest financial holding company in the United States. As such, it offers a broad array of corporate and consumer products and services of varying complexity through many business lines such as retail banking, investment banking, retail brokerage, merchant servicing, insurance, etc. As a result, many product and service offerings have a high degree of specialization and complexity that increases the likelihood of fraudulent activities. Managing and monitoring employee activity supporting complex businesses operations across a geographical footprint this size, with significant organizational dispersion, increases inherent fraud risk.

In addition to Wachovia's standard offerings, the acquisition of GoldenWest has introduced mortgage products with characteristics that are new to legacy management. However, overall operational risk is lessened due to management's decision to retain GoldenWest management and systems. Management has also made the strategic decision to expand existing lending and capital markets capabilities in Europe, establishing a subsidiary bank in Ireland to facilitate this project. At this time operations are outsourced to a local third-party financial institution (Allied Irish), heightening operational exposure. Management continues to look for other outsourcing opportunities, including forging ahead with the program to off-shore technology and business processes in India.

Due to the institution's complexity of operations and increasing domestic and global footprint resulting from acquisitions and international strategic initiatives, a significant number of sensitive positions are spread throughout the world heightening inherent risk. Further, the increase in outsourcing and offshoring increases the risk of inappropriate access to sensitive consumer data by third-party service providers.

Complexity of governance structures - Limited

Although interdependencies exist, from governance and risk management perspective, the company continues to move toward greater centralization. Several executive-level risk committees that have been established in recent years are beginning to mature and exert greater influence over operational activities. Enterprise control functions such as Corporate Audit and Corporate Risk Management continue to demonstrate greater stature and involvement in day-to-day operations; however, weaknesses persist within Technology Audit. Over the past year, accountability, especially with respect to the progress of the IT remediation issues, has shown improvement. The recent merger activity has added inherent risk by increasing the footprint of the corporation throughout the US and internationally, and by adding

new employees and service providers not familiar with Wachovia's governances processes and ethics.

Degree of human interaction / intervention in transactions - Moderate

The company continues to use technology solutions to increase the level of automation and straight through processing (STP). Currently, transactions processed throughout the various retail and wholesale payment channels are largely completed in this manner. Human intervention is primarily on an exception basis, where, for example individual customer transactions or a payment channel file is stopped because processing criteria was not met. For the company overall, most of the payment channels are mature processes that have achieved a high level of STP efficiency. In other areas of the company, however, such as in the Corporate and Investment Bank (CIB), operational challenges have been more pronounced. These business lines rely heavily on legacy systems to process transactions or trades and evidence a much higher level of required manual intervention, which management is working to address. Audit and the OCC have identified weaknesses in controls surrounding spreadsheets and other End User Computing Tools, and while some corrective action has been noted, management's efforts to strengthen the control environment have not yet reached full effectiveness.

Counterparty transparency - Limited

Overall, Wachovia is a well known entity and conducts the majority of business with other known financial institutions. However, Wachovia's name recognition lends the company to various fraud and theft attempts, both from internal and external sources. To date, these activities have not had a negative impact on the customer base or business client relationships. However, with the significant growth of the company's correspondent banking activities, and the added counterparty relationships that came with the acquisition of GoldenWest, inherent counterparty risk is gradually increasing. The GoldenWest acquisition increases the Bank's presence in Florida and California, both of which are operating areas known for higher fraud exposure. The reentry into the credit card business, having recently surpassed one million customers, means they will have more direct management and operational oversight of day-to-day credit card operations. This strategic initiative may encourage hackers to devise clever ways to approach Wachovia's credit card customers through Internet phishing and other means.

<u>Employment Practices and Workplace Safety</u>

Employee competence – Limited

The overall level of employee competence is considered satisfactory. Key management positions are staffed with seasoned individuals that possess the knowledge and experience to adequately perform their job responsibilities. Management continues to improve the governance of operational and technology risk, with previously executed senior leadership changes becoming more seasoned. The General Auditor has announced his intent to retire later in 2007. This position will be assumed by the Corporation's Controller, who is highly regarded in the organization and should be able to bring additional stature to the Audit function. The role of Controller has been filled on an interim basis internally, with no regulatory concern. While previous improvement had been noted, the true effectiveness of the Technology Audit function remains a regulatory concern.

The GoldenWest acquisition has presented management with challenges due to the fact that this organization has a unique business culture which may not easily translate into the revenue and cross-sales environment of Wachovia. At this time the ramifications of the WACHOVIA cultural overlay are unknown.

Key person risk - Limited

In general, key person risk is limited due to the diversity of operations and the depth of talent in the corporation. The recent internal promotions from within of the new General Auditor and Controller illustrate Wachovia's ongoing commitment to develop bench strength in their management team. Where there has not been a person ready or available internally with the required skill sets, the company has successfully hired management talent from outside sources.

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Staffing levels - Low

Overall employee staffing levels are sufficient to ensure all necessary positions are filled with appropriately skilled individuals. However, within technology there are indications of resource stretch for both "subject matter experts" and IT project managers knowledgeable of legacy systems and capable of leading enterprise scale projects. This exposure is due to the demands of CIS risk remediation projects, merger integration activities, and business as usual change initiatives. To date, management has dealt with this issue in a satisfactory manner through internal job scheduling and an aggressive program of outsourcing and offshoring of some technology work to India. However, they have found they cannot fill the need for legacy system subject matter experts, nor seasoned project managers with outsourcing resources. Consequently, this situation has restricted some of their business plans. With their size, diverse product lines, and services offered, management succession has not been a problem. As discussed earlier, the company has a large pool of talented managers from which to pull future senior managers.

Turnover - Limited

Turnover in senior business leadership, operations and risk support has been minimal, although associates do change job responsibilities from time to time. While there was attrition associated with recent acquisitions, the level of turnover was well within anticipated margins. Undesired turnover of key talent in the GoldenWest integration has been very low; however, management is aware that this is an area of potential heightened exposure due to their people dependent business model. To date, turnover rates in connection with the offshoring of application systems development and maintenance have also been within anticipated margins. Historical turnover levels have been marginal with little to no significant impact on processes. Employee morale throughout the company overall is considered good. This is attributable to a culture of strong communication flow, carefully scripted communications, other employment opportunities, and fair severance programs. However, management recognizes that the current business environment is very challenging, and while no wholesale job eliminations have been announced, expense tightening is being considered across the company. Additionally, management recently announced a restructuring which will impact several business lines and functions, but the impending operational and governance changes are as yet unknown.

Process - Considerable

Clients, Products, and Business Practices

New or changing products or services - Limited

The company operates in a very competitive market and must quickly respond to consumer demand for new products and services. Management has historically operated as a market-follower in regard to entry into new markets, and until recently has been viewed as conservative in its merger and acquisitions strategy by seeking several niche acquisitions in known markets over large mergers in risky lines of business. Additionally, the introduction of new delivery channels for existing products or services has been approached cautiously with the goal of promoting a high level of internal revenue growth through cross-selling of its full line of products and services. This philosophy may be changing with the company's recent announcement of plans to become a leader in mobile banking and offer higher risk customer services through hand-held devices such as cell phones by year end 2007. In addition, the GoldenWest acquisition has introduced mortgage and deposit products, with unique features, which are new to legacy WACHOVIA. The IT group is currently building capabilities into the legacy deposit platforms and systems of record to accommodate the conversion, but the strategic decision was made to not convert the mortgage systems due to unique inherent capabilities. This profile increases operational risk in the short-term as management digests the operational characteristics and established risk appetites associated with the GoldenWest organization.

In addition to GoldenWest, the recently announced $6.8 billion purchase of A.G. Edwards will form one of the largest retail stock brokerages in the United States with more than 3,300 locations, $1.1 trillion in client assets, and nearly 15,000 brokers. A.G. Edwards will become part of Wachovia Securities and will be headquartered in St. Louis, Missouri. Wachovia Securities will manage the acquisition and systems integration project.

Management also made the strategic decision to re-enter the credit card business as a direct issuer early in 2006. The transition from the MBNA agreement into the current issuer environment did not result in any operational breakdowns or customer data integrity issues. The company selected TSYS to handle the processing of transactions and RemitCo for customer payment capture. The OCC conducted a review in 1Q07 which noted that systems and controls are sufficient for operations, with no issues noted.

Annual Growth (on/off balance sheet), Consolidation or De Novo - Considerable

The company is adding scale and transaction volume by increasing its geographic presence to the west coast, while at the same time executing strategic initiatives to expand internationally. The successful integration of SouthTrust Bank added over $50 billion to total assets and resulted in further expansion of its footprint across the southeast and Texas markets. On the heels of this acquisition, the company purchased WestCorp and GoldenWest, adding over $125B in assets and over 300 branches, which provides entry into the California market plus supplement or new locations in other states. These acquisitions, plus the recently announced purchase of A.G. Edwards, complement management's strategic western expansion program which intends to add up to 40 new branches in California each year. Recent integrations have been well managed, and senior leadership intends to use the same proven model on this acquisition integration.

Market Competition – Considerable

The markets in which the company operates are very competitive with several traditional large and regional banks, as well as non-banking entities, offering a full range of products and services both domestically and internationally. This has caused management to continually evaluate its suite of products and services for its customer base. Historically, management has been conservative in developing new products, instead relying on exceptional customer service to attract and retain customers. However, operational risk is heightened as customer sophistication has resulted in increased demand for more complex and differentiated products, services and delivery channels.

Outsourcing / Offshoring – Considerable

Vendor risk remains a key operational risk facing the company. Due to competitive pressures and cost reduction objectives, Wachovia continues to aggressively pursue an outsourcing and offshoring program that will see the number of overseas FTEs increase from 700 in December, 2006 to approximately 2,100 by year end 2007. Additionally, management has (1) consolidated its in-country data network functions in a new facility near Delhi, (2) is completing a primary disaster recovery (DR) site and exploring locations in India for an alternate DR site, and (3) is distributing the expanded headcount across several geographical regions in India. This is a recent strategic shift for the company. Over the past twelve months, IT management has expanded the breadth and depth of the application development and maintenance (ADM) work it is offshoring to India using three service providers (Infosys, Cognizant, and IBM). To date approximately 200 application development/maintenance projects have been offshored with plans to offshore additional projects. Also, 38 business process operation (BPO) functions have been offshored and are in steady state (fully transitioned); while another 25 are in transition through the offshoring process with GenPact to sites in India and Mexico. Offshored activities include parts or all of the following back office business processes: 1) AmNet post-closing loan review, 2) retirement plan account reconciliations, 3) accounts payable reconciliations, duplicate payment research, and check resolution, 4) mortgage post-closing, 5) commercial loans collateral servicing, 6) commercial real estate servicing, and 7) trust accounting reporting.

In addition, management recently announced they will be opening a customer call center in the Philippines supported by their India-based service provider GenPact. The rationale for the additional capacity is internal demand/growth for call center resources, and is not expected to result in the closing of any of their thirteen USA-based call centers.

Also, management is evaluating opportunities to transition complete (end-to-end) business processes to their India-based service provider GenPact starting in first quarter of 2008. The partial business processes that are currently in transition to India are expected to be complete by year end 2007. Going forward, the number of whole and partial business processes offshored will grow and is expected to include other GenPact locations around the globe. Along with the continued offshoring of IT application development and maintenance work, management is evaluating sending

part of their systems development and maintenance work to other international locations so as to avoid an excessive concentration in India. With continued year over year growth in the number and variety of offshored business processes and IT projects, the inherent risk of unauthorized access to confidential and/or sensitive customer information remains considerable.

Execution, Delivery, and Process Management

Product and Services Complexity - Moderate

Wachovia offers a wide spectrum of financial products and services. The company functions as a full-service depository institution for retail and commercial customers, supplemented with wealth management, investment banking, insurance, and full-service broker/dealer operations. The strategic decision to expand lending and capital markets activity in Europe will involve complex, yet known products; however, local regulatory implications and the use of a local third-party service provider for operations heightens the risk exposure in the short-term. Through its mergers and acquisitions growth strategies, Wachovia continues to add products and services that both complement its "one-stop" shopping goals and increase the breadth and complexity of its product line, most notably with the integration of GoldenWest's unique mortgage and deposit products from the legacy thrift environment. The complexity of the Corporate & Investment Banking (CIB) segment is undergoing significant technology support enhancements and process improvements aimed at strengthening internal controls and enabling existing business processes to handle larger transactional volumes as this line of business grows.

Straight through processing - and the Use of Grid Computing- Moderate

Wire transfer and ACH activity is largely conducted via straight through processing with only a marginal percentage of transactions requiring manual repair. Transactions processed through the various retail and wholesale payment channels are mostly automated. As would be expected for an institution this size, single customer and file transaction volumes are large across all channels. Each payment channel is independent of the other, thus creating additional processing complexity and the potential for cross-channel payment risk. Human intervention is primarily on an exception basis – i.e. individual customer transactions or a payment channel file is stopped because all straight through processing criteria was not met. Most of the payment channels use mature processes, having achieved a high-level of straight through processing efficiency. Within the Corporate and Investment Banking business unit there has been substantially more reliance on manual transaction processing largely due to the lack of mature, integrated, and reliable applications and processes. However, inherent risk is changing rapidly within CIB with the approval of a three-year project to simplify, streamline, and integrate the applications, and add capacity to the IT application architecture. This project began in 2006 and it will continue through 2008. In addition to changing the systems architecture to straight through processing, the new transaction processing environment will utilize a service oriented architecture (SOA) and "grid computing" (e.g. the use of spare computing capacity in hundreds of inactive PCs attached to the Wachovia network at any point in time).

Volumes – Limited

Wholesale and retail electronic payment channel activity is dominated by a few products: wire, ACH and debit card. Domestic and internal wire transfer activity is processed one transaction at a time. In 2006, the bank processed approximately 1.4 billion ACH items and 1.7 billion debit/ATM card transactions. ACH transactions are processed throughout the day in batches, and debit card batches are processed once each evening. If transaction volumes were defined in terms of batches processes, the transaction volume numbers would be much less. Additionally, for 2006 the company processed approximately 15.6 million wire transactions. While electronic transaction trends are increasing, check volume decreased by eight percent in 2006. Currently, six million check images are sent each day, with two million received. Regardless of how volume is measured, Wachovia has the capacity to effectively process all activity. Management, however, is taking action to address future capacity needs. It is expected that the disaster recovery plan that is currently being revised will the consider capacity needs with the build-out of the Oxmoor data center.

Monetary Value - Moderate

Wire transfer and ACH transactions vary greatly in size from small to extremely large. As the nation's fourth largest financial institution, the volumes of these types of transactions are large and in line with the many products and services the institution offers its retail and commercial customers. Dollar values processed are largest in wire transfer where 2006 activity, both domestic and international, amounted to 15.6 million transactions totaling $18.7 billion. ACH amounted to $5.1 trillion. Debit card activity in aggregate is sizeable ($54 billion), but minimal on a per-transaction basis ($42). The failure to execute, deliver, or process within any payment channel would create temporary financial risks possibly resulting in some financial loss to the bank, with the potential for longer term reputational risk.

Systems Conversions / Integrations - Considerable

The company frequently undertakes systems conversion/integration events. Whether it is integrating the systems from a recent acquisition or upgrading new platforms such as the G/L conversion, IT management usually is challenged. Technology management is using its offshoring capabilities to the fullest potential as it works through the current system conversions and integration activities – the two most recent being the acquisitions of WestCorp and GoldenWest. In some cases Wachovia elected to move the acquired assets and customers to its legacy systems; in a few other situations, Wachovia elected to use the acquired system as the destination due to its best in class functionality (e.g., some WestCorp systems). In both situations, two constraints have surfaced, 1) a shortage of 'subject matter experts (SMEs)" with strong knowledge about the inner workings of the destination system, and 2) project and program managers capable of leading complex enterprise conversion/integration projects. Neither of these skills is readily available through Wachovia's offshoring resources; however, over time, SME skills are being developed at the offshoring vendors.

Systems - Considerable

Business Disruption and System Failures

Technological Complexity - Considerable

A layered series of mixed technology architectures has evolved over time adding to the complexity and the challenge of maintaining production stability and systems availability. Efforts have been underway to improve and replace some outdated systems and technology infrastructure with the result that IT systems availability service levels average about 99.9% today. This technical complexity and management's strong focus on maintaining a high level of system availability is a key factor in their plans for using the new "Oxmoor" out-of-region data center in Birmingham, Alabama. This facility is being constructed to facilitate the recovery of the institution in the event the primary and backup data centers in Winston-Salem, North Carolina are simultaneously impacted. If a catastrophic disruption were to occur today, Wachovia management estimates the recovery time at a minimum of sixty calendar days. Consequently, management has approved and funded a four year project (2007 through 2010) to unbundle the production processing at the Silas data center in Winston-Salem, North Carolina and move approximately half to Oxmoor. Eventually, the current "West End Computing (WEC)" backup site in Winston-Salem will be retired leaving Silas and Oxmoor as paired facilities - each capable of backing up the other in the event of a business disruption.

Level of systems and business line interdependency - Moderate

While the company operates and manages a technology environment characterized by a disparate portfolio of technology infrastructures, applications, and reporting systems, legacy systems are generally stable. Considering the company's current IT architecture, core systems remain fairly interdependent.

Geographic Diversity – Information Technology/Operations - High

Inadequate disaster recovery capabilities have been reported as a serious control weakness by the regulators since 1999. While risk mitigation has been slow, progress is being made in reducing overall BCP risk in the company. The company's business resumption capabilities have improved through greater testing rigor, the application of advanced technology solutions, and the addition of extra workspace recovery facilities through the build out of the Raleigh Regional Recovery Site. However, much work remains.

Reducing the time recovery gaps in the business continuity plans has been an ongoing project that has spanned several years. In 2005, management completed a review of BCP recovery time objectives (RTOs) to ensure consistency and appropriateness. The review resulted in several applications being accorded a longer RTO thereby eliminating a majority of remaining application recovery gaps. With the 2006 decision to begin moving some production processing from Silas to Oxmoor, management acknowledged that individual BCP plans will need to be updated (as their systems move to Oxmoor). This migration has introduced approximately 450 miles of geographic dispersion into the recovery environment. This change means 1) the backup data communications architecture will change from synchronous to asynchronous communications and will have to account for the risk of loss of transaction data, and 2) the application recovery plans will need to include defined points in the system process (Recovery Points) where it is safe to restart each application following a business disruption. This will require the continued attention of business and technology management to stay current.

Data center risk has been a long-standing supervisory concern that the Federal Reserve has been raising since 2003. Independent consultant reports also concluded that data center proximity risk is high. Corporate Risk Management in October 2004 concluded the combination of data center proximity and business work site concentration risks were unacceptable, and in 2006 further concluded the company would be "out of business" for a minimum of 60 calendar days until it was able to construct, fully equip, and test the new tertiary recovery center in Birmingham, Alabama. We are pleased the company has completed construction of a third data center ("Oxmoor") near Birmingham, Alabama to diversify IT production and backup resources. During the second quarter of 2006, a team of subject matter experts developed a long-term data center strategy for the corporation that lays out a four year project of unbundling the production systems at the Silas center in Winston-Salem, moving half to Oxmoor, and eventually retiring the current backup center in Winston-Salem. Thus, Wachovia's data center proximity risk will not be reduced to an acceptable level until the Oxmoor center in Birmingham, Alabama is fully operational – and this is not expected to occur until mid-2009 at the earliest.

In addition to the data center proximity risk, there is also a high concentration of over 10,000 business workers at Wachovia's employee Customer Information Center (CIC) in Charlotte, North Carolina. This results in the conclusion that geographic dispersion of key business functions is a continuing risk for the company.

Participation in Payments and Settlement Systems - Low

Wachovia's international funds transfer activities are managed by the Correspondent Banking Operations Group located in New York and Philadelphia. This group manages the clearing and settlement of most wholesale international payments for the company. Various technology applications are used to process payment activities including Integrated Funds Transfer (IFT) and the SWIFT Alliance payment messaging systems. Wachovia also clears and settles international payments through the Clearing House Interbank Payment Systems (CHIPS) network. The preponderance of international funds transfer processing is conducted out of New York, with sizeable offshore payments activity originating from branches in London, Taipei, and Tokyo. Most international payments are processed by Integrated Funds Transfer (IFT) system. All IFT processing is hosted on its own separate DDA system, IIS (International Information System). Over 50 percent of the company's fund transfer volumes flow through the IFT system.

Systemic Payments Risk - Limited

Wachovia participates in many wholesale and retail systems with established infrastructure and controls. The company is approaching significant participant status as defined by the "Sound Practices Paper".

External Events - Limited

Environmental Events - Limited

Overall, company exposure to environmental threats is limited as the company's center of operations is not in areas that are known to be greatly susceptible to natural disasters. However, though isolated, in the past the company has experienced weather-related outages due to ice storms and hurricane damage. The build-out of recovery capabilities in

Birmingham, Alabama will provide additional geographic dispersion, but the company will retain exposure to hurricane implications. Additionally, with the WestCorp and GoldenWest acquisitions and expansion into California, the potential effects of an earthquake are introduced into Wachovia's risk profile.

The prospect of an avian flu pandemic remains a consideration, but experts still predict a low probability. Should that, or another wide-scale disaster occur, the company could be significantly impacted in view of the large concentration of senior leadership, management, and operational employees in Charlotte, North Carolina.

As the fourth largest financial institution in the US, the company has a heightened exposure to direct terrorist threats; however, with primarily domestic operations, the likelihood is lessened. However, risk remains due to collateral damage from counterparty exposure in the financial sector. Additionally, having primarily a domestic operations footprint today provides some protection against the risk of political instability, but international growth and operational off-shoring strategies increases the risks of exposure to political instability and terrorism.

Operational Risk Management and Controls -- Satisfactory

Operational Risk Management and Controls	Risk Management and Controls																			
	Board and Senior Management Oversight					Policies & Procedures	MIS and Risk Monitoring				Internal Controls and Audits									
	Board Governance Structure & Oversight	Management Governance and Oversight	Performance Incentives	Staffing Adequacy	New Product/Service Introduction	Operational Risk Policies and Procedures	MIS Reporting	Self Assessments	Loss Event Data	Measurement Models for Operational Risk	Internal Controls	Information Technology	Information Security	Operational Risk Modeling Validation	Accounting and Financial Controls	Outsourcing	Business Continuity Planning	Insurance	Internal Audit	External Audit
Individual Factor Ratings	Sat	Sat	Fr	Sat	Sat	Satisfactory	Sat	Sat	Sat	Sat	Fr	Fr	Fr	Sat	Sat	Fr	Fr	Fr	Sat	Sat
Overall Rating	Satisfactory						Satisfactory				Fair									

Risk Management – Satisfactory

Overall, operational risk management practices are considered satisfactory, and management is generally receptive to remediation of issues identified by Audit or Regulators; however, certain significant timeframes for exposure remediation have prolonged the heightened risk environment. Operational risk management practices are a combination of direct business or function oversight and support from corporate functions and validation from Audit. While current practices are satisfactory, as evidenced by a lack of material single event losses or operational breakdowns, strategic growth initiatives have the potential to tax the infrastructure if it does not keep pace with the changing environment. Overall Audit continues to show improvement and is rated as a satisfactory risk and control function, but regulatory concerns remain with respect to IT Audit and the Audit Project Office.

At Wachovia the Board has the ultimate responsibility for ensuring a sound operating environment. This is accomplished through the utilization of both a Risk Committee and the Audit Committee, both of which are considered capable. On a daily basis the management of, and accountability for, operational risk is the responsibility of associated business or function leadership. This ownership is supported by corporate operational risk and other centralized functions. As the process of formalized operational risk management continues to mature at the company there has been evidence of improved coordination between risk owners and support units. The independent Corporate Operational Risk Management (CORM) function continues to mature and gain stature within the company, and regulators have noted management's strong commitment to this function. CORM is further supplemented by individual functional risk managers who have responsibility for specific operational risk elements across the company in an effort to drive consistency.

As the company continues to move from a decentralized to a centralized management model, additional firm-wide policies and standards are being developed. That said, the firm continues to experience challenges implementing and executing the standards on a consistent basis. To remedy this CORM has recently implemented a monitoring program to more proactively identify areas of non-compliance with standards. However, CORM lacks enforcement capabilities under the current culture.

Wachovia's risk monitoring and management information systems (MIS) are satisfactory given the risk profile of the company, but continuing enhancements are needed as the company expands its product offerings. High level senior management reports give a broad and accurate review of the key risks facing the corporation, however, recent OCC and FRB exams have communicated the need to clearly identify technology risks in Board and Operating Committee reports. Internal risk assessments have been completed for the most significant areas of the company; however, there is currently no company standard template for business self-assessments. While individual risk assessments are judged to be accurate, the lack of consistency across the firm challenges CORM's ability to effectively aggregate risk and opine on the quality of overall risk management practices. A recent regulatory review of scenario analysis processes revealed that CORM has adequately formalized a process framework, but implementation and execution efforts were inconsistent.

Internal controls are generally considered satisfactory and it is clear that business and functional management own the risk and responsibility for implementing a satisfactory control environment. That said, the slow progress mitigating the

proximity risk of the company's two data centers and a lack of final, and proven sustainable resolution to the information security remediation programs result in an overall fair rating for controls. Outside of these issues, senior management of the company has demonstrated a commitment to address weaknesses in the control environment, as evidenced by improving percentages of satisfactory audits and a reduction in the days outstanding for issue resolution. Moreover, management continues to strengthen technology governance practices and these enhancements are beginning to mature, but full effectiveness and sustainability have yet to be achieved. Accounting controls are sound, with a noted decrease in the outstanding significant deficiencies and no material weaknesses. Management continues to struggle with consistent and effective vendor management practices, heightening risk exposures. Offshoring capabilities are expected to significantly increase, and while management has provided effective oversight to date the changing complexion of moving full business processes could challenge current governance structures.

As overall audit performance improves, management continues its efforts to promote the corporate stature and effectiveness of the audit program. The announced retirement of the current General Auditor, combined with the expected replacement, should further efforts to enhance the function. In consideration of the overall improvement of Audit as a whole, slippage has been noted in the Technology Audit and Audit Project Office functions. In these areas significant deficiencies were noted in the information security remediation work, and these groups failed to detect the deficiencies and challenges which negatively impacted the RDS database project. The regulatory concern over these two elements of Audit has been conveyed to management.

Board and Senior Management Oversight - Satisfactory

Board Governance Structure & Oversight - Satisfactory

The current Board of Directors is an eighteen member group of experienced and individually successful bankers, business owners, and managers with numerous outside interests. The president of the bank is the Chairman of the Board, with all other members, except one former employee, being independent. The Board is viewed as capable, appropriately engaged in the management of the company, and responsive to regulatory issues. The company has recently followed the current best practice of electing one of the outside directors as a "Lead Director" to provide shareholders a vehicle to communicate directly with Board leadership without having to go through company management. The broad diversity of Board membership adds a high degree of business expertise and acumen to the leadership.

The Board uses two main committees to oversee corporate risks, the Audit Committee, (comprised entirely of independent directors), and the Risk Committee (f/k/a/ Credit and Finance Committee which includes one director not considered independent as he was a former employee of acquisition WestCorp.) These Committees have their roles and responsibilities clearly defined in formally adopted charters which appear appropriate for the size and complexity of the organization. All members of the Audit Committee are considered financially literate, and the Chair is designated as a Financial Expert under SEC definition. These two Committees meet regularly to discuss the highest risks facing the company. Audit Committee reporting is currently undergoing enhancement to focus on providing a clearer perspective of risks faced by the company, and risk management practices.

Senior Management Structure, Qualifications and Effectiveness – Satisfactory

Executive leadership has established a governance culture of ownership and accountability for risk management at the business or functional level. This is supplemented by risk management and operational support functions. We have noted better coordination among Corporate Operational Risk Management, the business units, Corporate Technology Risk Management, and Internal Audit. Operational risk is managed in a generally effective manner, and management has been generally receptive to remediation of issues identified by Audit or Regulators. However, the significant timeframes for full remediation on significant exposures (information security, data center proximity) has prolonged the heightened risk environment.

Senior management monitors and manages the affairs and risks of the company through four main committees -- the Senior Risk, Credit Risk, Market Risk, and Operational Risk Committees. The Senior Risk Committee (SRC) meets monthly and is comprised of Tier 1 managers including the President, Chief Risk Officer, and the heads of the four main business units. The General Auditor is an ex-officio member. The SRC manages and monitors the key risks in the

company and acts as an executive level management committee. The Credit Risk, Market Risk, and Operational Risk Committees actively manage all the activities of the Company in their respective areas. Additional risk committees exist and function beneath these four to ensure appropriate risk management across all business lines, plus effective communication and execution of corporate initiatives.

The independent Corporate Operational Risk (CORM) function, while recognized as a work in process, continues to mature and gain stature within the company. Recent regulatory activity noted senior leadership's strong commitment to operational risk and the clear delineation between CORM governance framework ownership and business or functional ownership of risk. However, the lack of enforcement capabilities on the part of CORM could result in gaps in the overall risk management process. Within the individual lines of business or support functions are Operational Risk Managers (ORMs) who take an active role in deploying the OpR governance framework. In addition, they assist business or functional management with the identification of risk management objectives, goals and tolerances. These dedicated risk managers also establish an annual coverage plan that outlines what activities they, and unit management, will conduct to ensure effective operational risk management. Finally, within the ops risk management program there are individual functional risk managers (i.e., Functional Risk Area leaders – FRAs) who have risk management accountability across the company for individual risk elements (IT, Legal, HR, etc.).

Senior leadership has commissioned a risk management oversight initiative which is designed to evaluate multiple internal risk governance mechanisms (Audit, CORM, SOX, CIS, Compliance) for duplication and effectiveness. Management has stated that the foundation of this project is the establishment of clarity on roles and objectives, as well as the definition of clearer risk tolerances. Although it is too early in the process to form conclusions, regulators will be tracking this initiative to ensure it is not simply a high-profile cost cutting exercise.

Basel II Oversight

Board and senior management oversight of Basel II is ongoing. Audit rendered a less than satisfactory report on the organization, staffing, and leadership of the initial Basel compliance efforts during the first half of 2005. In response, management reorganized the project team. New leadership was brought in and IBM Corporation was hired to assist in developing the technology plan to design and create a Risk Data Strategy (RDS) database. This database is to be the foundation for the Basel data analysis and reporting processes. The Audit Project Office assigned staff to the Basel work effort to provide executive management with an objective monthly assessment of project progress and challenges. The Federal Reserve and OCC regulators are meeting monthly with audit, risk, and Basel II project management office to assess progress.

In October, 2006, the Risk Data Strategy (RDS) data warehouse project encountered a major setback when IBM announced the data model it was using to build the data warehouse for Wachovia was too complex and would not work. That announcement delayed the project several months and resulted in a realignment of the project team and the assignment of a new Wachovia program manager. IBM's role was also realigned. The model was also redesigned with a reduction in the number of data base elements from over 3,000 to less than 500. The project team was also directed to focus solely on satisfying the requirements of Basel II. The creation of the RDS data warehouse remains in "Red" status and continues to be a "bottle neck" limiting Basel II implementation activities.

Until recently, the Treasury function at Wachovia had centralized oversight for Basel II preparedness through the Basel Project Management Office (PMO), plus a dedicated sponsor and a manager. In May 2007, the responsibility for the Basel Project Management Office moved to the Risk Management function under the leadership of the Chief Risk Officer to improve visibility and accountability. In addition to the PMO, Wachovia also has a Basel II Executive Steering Committee, and a Basel II Stakeholder Committee. The former's scope is executive summary reporting, industry updates, and strategies, while the latter's includes many of the same items plus project strategy/scope, interdependencies, and communication. CORM and Credit risk also deal with Basel II and are discussed in their respective sections.

Performance Incentives – Fair

Because of the size and business line diversity of Wachovia, there is no one standard model used for performance

incentive programs. Most performance programs are designed around targeted goals, objectives, or expectations, with a strong fundamental focus on financial performance. There is currently no specific methodology for inclusion of operational breakdowns or control weaknesses into incentive compensation, other than individual notations in performance appraisals.

Staff Adequacy - Satisfactory

Overall, the company has a good record of attracting and retaining qualified employees, with historical evidence of developing leadership internally. Other than losses attributable to business as usual operations, the company has not experienced significant operational losses or breakdowns as a result of inadequate staffing. Management's strategic decision to pursue offshoring options in India are the result of financial and efficiency considerations and do not reflect staffing shortfalls. However, with the number of significant IT risk remediation and business acquisition integration projects currently underway, resource strain has been noted with IT subject matter experts and experienced project managers. Additionally, cost overruns and rework noted in high-profile initiatives, such as the Basel Risk Data Strategy database project, may be symptomatic of a lack of qualified program managers for large, complex, enterprise projects. Management is aware of this risk and has created a team of executives to examine the underlying causes of projects that have not met expectations over the past 2-3 years. Lessons learned will help senior management staff and structure new enterprise projects in the future.

New Product/Service Review - Satisfactory

There are currently six new product review committees in the company, organized by major business unit. Additional committees have been established by the Treasury Division and Wachovia Mortgage Corporation. The charters of these committees state that the overriding objective is to "…enable business unit leaders to make informed decisions that would introduce new products or materially alter the risks associated with existing products." Prior to introducing a product or service, the related committee(s) reviews all aspects of the plan including the associated risks and benefits. There is currently some representation by functional support partners (IT, Legal, Finance, etc.), but this has yet to achieve consistency across the company.

Policies, Procedures, and Limits - Satisfactory

Operational Risk Policies and Procedures - Satisfactory

As the company continues to move from a decentralized to a centralized management model, additional enterprise-wide policies and standards are being developed. Management has devoted considerable effort to standardizing areas such as information security processes, change control practices, business continuity planning, and rudimentary accounting controls. Management has established a corporate systems development life cycle (SDLC) process that governs all systems development activities across the company. Also, the de facto policies, procedures and limits with respect to Basel II are currently issued as guidance documents.

From a project management and program funding perspective, management has implemented an enterprise "Investment Review Board (IRB)" to evaluate all requests for project funding and ensure they are 1) properly staffed and scoped and 2) will benefit the entire corporation. One noteworthy requirement of the IRB is that all proposed complex programs/projects must have a person identified to lead the effort. This leader must have a proven track record of leading large complex assignments *before* the IRB committee will fund the activity. The purpose of this requirement is to reduce the risk of failure due to poor leadership and thereby avoid the "double expense" of a failed endeavor.

From a risk perspective, the CORM function has developed an operational risk management framework, and oversight standards, they believe are designed to comply with the requirements of Basel II. Responsibility for acceptance and adoption of the framework falls to the individual businesses and support functions. Performance of the oversight element actions is divided between CORM from a firm-wide perspective and the individual Operational Risk Managers (ORMs) at the business or function level.

However, CORM under the current governance culture does not have standards enforcement capability. CORM

recognized they had a gap in monitoring compliance with the oversight program and undertook the development of a defined monitoring program. However, the monitoring program as currently designed lacks full effectiveness as it simply documents whether a framework element has been completed, not whether the completed actions are appropriate or effective. *Consequently, OpR does not render an overall opinion on the level of inherent risk across the enterprise, or the quality of business unit risk management practices. The question management and the regulators are debating is whether those two duties fall under the duties of the Chief Risk Officer, or whether they fall under the duties of the General Auditor.*

To ensure all technology processes are governed consistently across all business lines, senior technology management has developed a common framework called the "IT Operating Model". This framework is based on "Capability Maturity Model (CMM)" concepts and establishes the structures necessary for managing IT including:

1. Defining clear roles and responsibilities for decision making and accountability.
2. Identifying key capabilities associated with strategic planning, risk management, and financial management.
3. Revising and expanding existing policies and standards for relevancy and effectiveness.
4. Establishing a definitive compliance and enforcement process.

Risk Monitoring and Management Information Systems (MIS) - Satisfactory

MIS Reporting - Satisfactory

Operational risk reporting for Wachovia, like the industry, remains in an evolutionary state. However, management's implementation plan for the corporate-wide program is progressing, and the objectives of reporting are defined in a formal strategy. Management has instituted both enterprise and segment level reporting for the four main businesses and major support segments. The main report for the firm is the Significant Operational Risk (SOR) report, which is prepared for the Board's Senior Risk Committee, the Operational Risk Committee and senior management. The report is an overview of the fifteen significant operational risks (inherent and residual), as defined by CORM, across the businesses/segments, and a limited aggregated picture for the company. Additionally, this reporting includes narratives on significant operational risk trends and operational risk capital. While this reporting is acknowledged as a positive step, enhancement opportunities exist with respect to CORM's opinion on the effectiveness of operational risk management practices. Also needed are clearer ties to loss events and BCIEFs, descriptive commentary, and discussions on quarterly changes4. Additionally, a lack of commonality of risk definitions and assessment tools currently challenges CORM aggregation efforts for a firm-wide perspective.

Corporate Technology Risk Management has published policies and procedures that define its role and responsibilities in the IT governance process, and recently completed an enterprise risk assessment of Gramm-Leach-Bliley Act (GLBA) regulations that were the basis for several long-running IT risk remediation projects over the past 3 years. To date, the IT risk management group has demonstrated a reasonable capacity to identify risk and establish appropriate IT remediation requirements. An examination of the Corporate Technology Risk function is currently underway. During the 2006 examination, the OCC commended management for progress made to date, while at the same time rendering a "Needs Improvement" rating due to the absence of documented IT risk management policies and procedures. In response to examination findings, IT risk management and the entire operational risk management function have implemented a clear and concise "business self-assessment (BSA)" reporting process that is updated quarterly. This BSA identifies the 15 most significant operational risks facing each line of business, as well as the 15 most significant operational risks facing the information technology functions across the company. In addition, the IT risk management function assisted IT management in implementing a "Risk Portfolio Management (RPM) process. This process tracks all reported risks (emerging, self-assessed, audit reported, etc.) and meets monthly to decision the actions necessary for each as of that point in time (remediate, accept, research, etc.).

Self-Assessments - Satisfactory

Business line risk assessments and relevant data capture efforts continue, and corporate communication supporting the corporate operational risk framework remains satisfactory. Risk assessments have been completed for the most

significant areas of the company and stored in the Centerprise database. However, there is currently no company standard template for business self-assessments. Management believes the unique nature of each business unit and support functions requires flexibility to allow tailoring to the individual profiles. Historical regulatory monitoring of the various self-assessments indicates they appropriately identify the risk of that business or segment on an individual basis. That said, there is concern about the lack of commonality of risk definitions and assessment tools. This issue could challenge the CORM's ability to effectively aggregate risk across the firm and opine on the quality of risk management practices.

Regulators recently conducted a review of Wachovia's scenario analysis process. This review revealed that CORM has adequately formalized an appropriate corporate scenario analysis framework, including policies and procedures. Management commitment for the program was clear. However, implementation and execution of the standard program was inconsistent, which could impact CORM's ability to rely upon, and effectively aggregate, the results. This inconsistency further demonstrates CORM's lack of standards enforcement capability across the company.

Loss Event Data - Satisfactory

Overall, Wachovia has made good progress on loss event data collection. Wachovia has an internal loss event database and process for collecting loss event data by major line of business and event loss type. Wachovia has also been using an external database from the Operational Risk data eXchange Association (ORX) to supplement/compliment their internal database. Although loss event data has been integrated into the operational risk economic capital process, it should be noted that it has been used solely for scenario analysis and to compare against internal data. External data is not explicitly used in the operational risk economic capital model.

Bank policy requires business units and support areas to record and document their operational risk losses as defined in bank regulations and by Corporate Operational Risk management. Accordingly, all operational risk losses in excess of the established thresholds are recorded in the loss event database. Documentation is produced at the time financial impacts are recognized in the financial statements. The unit that experiences an operational loss ensures that all related loss information is approved and recorded in a complete, accurate, and timely manner. On a monthly basis, Centerprise data is verified to data provided from case management systems. Steps to further automate and improve loss data collection efforts from non-GL based systems are in progress.

Wachovia is a member of the ORX consortium and uses ORX data for "industry" data. ORX is a not-for-profit organization owned by its members, providing members with operational risk related loss information, made anonymous by an independent custodian. Joining the ORX consortium greatly improved the quality of Wachovia's external data. Loss event data from Wachovia losses is submitted to ORX database. The characteristics of the 18 ORX members are similar to Wachovia with the portfolio size of the institution members averaging $570 billion, and $17.5 billion total revenue.

Measurement Models - Satisfactory

Significant improvements have been made over the past year in the quantitative methods for estimating operational risk capital. Despite being a reasonable method for computing capital at the enterprise level, the model is simplistic in nature and introduces components that are highly subjective. Operational risk capital is estimated at the top-of-the-house and then is distributed to each business segment. The computational method for capital at the enterprise level essentially uses empirical sampling without assuming any distribution. In that sense, the methodology is unique among its peers. A bank of Wachovia's size and type typically uses some type of distribution to fit the severity of its operational losses. The model is also unique in that it does not use Monte-Carlo simulations in computing the aggregate loss distribution. The Poisson distribution is used for frequency. The loss distribution is generated using First Fourier Transform (FFT). To the best of our knowledge, no other institution has used such a method. Most peers are using a loss distribution approach (LDA).

There are three types of data that are being used in the random draw of the severity data to generate the loss distribution -- historical losses, pending litigation, and the data generated out of scenario analysis. The scenario analysis uses external data and therefore there is no explicit use of external data in the model. Wachovia uses an arbitrary weighting

scheme to put unequal values to different segments of the data. Under this scheme they can choose to ignore some amount of data of one type and put more emphasis on the data of other type out of three different types. This can result in many different capital estimates.

For the purpose of business segment allocation of capital, Wachovia uses the same method as described above to compute the capital at business level. The business segment capital number is computed at a 95% level whereas the top of the house capital number is computed at the 99.96% level. Although this approach produces reasonable numbers, the Model Validation and Approval group (MVA) recommended that sensitivity analysis should be performed to support the choice of the stand-alone 95th percentile. Calculation of capital by the event types is not performed. Implicitly this is taking a full diversification benefit.

Although the model was recently validated and approved by MVA, some of the conclusions and opinions conflicted with those provided by examiners in late 2005. In the meantime, both examiners and members of MVA agree that more work is needed. While there is no clear agreement in the industry on the most appropriate approach to model operational risk, MVA noted that model benchmarking should be performed in order to mitigate model risk. Accordingly, examiners will continue to monitor and evaluate work done in this area.

Internal Controls & Audits - Fair

Internal Controls – Fair

In terms of governance, it is clear that business and functional management own risk and the accountability for designing and implementing a satisfactory control environment, with supplemental control support from independent functions such as Finance, Legal, Compliance, Operations and CORM. Independent of the IT and data center remediation projects, management is able to correct deficiencies in the normal course of business and under reasonable timeframes.

From an operating perspective, while management continues to address longstanding IT weaknesses, the overall condition of operational controls remains fair. The fair rating will continue until all the IT weaknesses are remedied to an acceptable level of residual risk and achieve sustainability. Independent of the IT issues, general operating controls in core banking activities are functioning in a satisfactory manner as evidenced by a lack of significant operational breakdowns, financial restatements, or material operational loss events. Further, Audit statistics reflect a 10% increase in total satisfactory audit reports (85%), which according to the General Auditor is a reflection of the improved control environment. (While this may be true, Audit does not re-report issues previously identified in other audits. This philosophy could result in higher report ratings even though known issues, albeit under remediation, exist.)

Technology risk remediation is viewed by management as the company's highest priority. The process of fully remediating the IT control environment to an acceptable level of risk required significant oversight effort on the part of Internal Audit during 2006 and 2007. Technology Audit work paper reviews were conducted by the OCC and Federal Reserve in third quarter 2006 and first quarter 2007. These reviews noted that Audit oversight was inadequate. As a result, additional audit resources were assigned, and Internal Audit management is expected to render an opinion to management and the Audit Committee in June. In addition, Technology Audit management changes were made in February, 2007 so as to ensure the audit validation work was done correctly from that point forward.

Software change control practices have varied widely across the company. Poor distributed software change control resulted in a number of system availability problems in 2004. The Chief Technology Officer (CTO) acknowledged that software change control was a company weakness. Management launched the Distributed Software Change Management (DSCM) project three years ago to establish a standard enterprise-wide process to standardize software changes in the distributed environment. The project was successfully completed in August 2006.

Corporate standards governing end-to-end systems development life cycle controls (SDLC) at Wachovia have been a challenge. An enterprise SDLC process allows for a more efficient IT process and consistent delivery of work. It also allows for better integration with other capabilities, such as project management, enterprise architecture, source and executable code management, availability management, and corporate information security. As a result of prior

regulatory SDLC examinations, management began development of a corporate SDLC governance office, a corporate strategy, and an architectural direction for SDLC process and tools. The policy and standards for the Enterprise SDLC were ratified and communicated across the institution in 2006.

GLBA-related information security policies and practices, data base security, and application access controls were also the subject of three of the long running IT Risk Remediation projects. IT management announced in December 2006 they were generally complete with all three efforts -- with the exception of the platform access components of each effort -- and that work was ongoing. Since then, progress has been made in restricting unauthorized access to the mainframe and mid-range computing platforms. However, technology challenges have slowed progress in resolving platform access control weaknesses for Unix and Windows servers. The latest estimate of when the platform access remediation work will be complete extends beyond year end 2007. For that reason, this work is expected be classified as a new IT risk remediation project.

Until all platform access issues are resolved, the OCC and Federal Reserve have agreed not to define the information security, data base security, and distributed software change management risk remediation projects as successfully complete. This is because improper platform access can undermine the internal control structures implemented through the other IT risk remediation projects.

Information Technology - Fair

The breadth and reach of information technology systems within Wachovia are considerable. Managing technology risk across the company remains a large challenge and continues as a high supervisory concern. As technology-based innovations evolve rapidly and are introduced into the marketplace, Wachovia has become increasingly dependent on them to remain competitive and meet business unit requirements. Thus, strong enterprise risk management practices remain a company imperative. Wachovia has hired effective technology leaders from other institutions and is making progress toward standardizing, stabilizing, and better controlling its complex technology environment. The technology risk issues the company faces today did not occur overnight and are the result of a confluence of events including: 1) rapid growth through mergers and acquisition, 2) a historically decentralized management structure, 3) a large number of internally development systems, 4) aggressive implementation of offshoring opportunities, 5) managing IT from a cost-focused perspective rather than a risk-focused perspective, 6) a weak prior corporate governance framework, and 7) a weak Technology audit function.

Consequently, supervisory concern has focused on the need for management to address several longstanding IT control and risk reporting deficiencies including corporate information security, GLBA, business continuity, and enterprise change management, systems development life cycle, and data center proximity. Management agreed and began upgrading its IT management team, strengthing internal controls in the IT organizations, implementing an effective IT operational risk function, upgrading the internal IT audit organization, and developing a long-term data center plan.

Several key IT and risk governance bodies were created to provide executive oversight of these projects and IT governance overall. The Senior Risk Committee and Technology Risk Committee were established to meet these objectives. These governance structures have provided the necessary foundation for the success of the IT risk remediation initiatives as well as the continued improvement in IT operations. Efforts to 1) improve senior management oversight, 2) strengthen executive accountability, 3) restructure project management practices and funding, 4) prioritize risk remediation activities through the newly established Risk Portfolio Management (RPM) process, and 5) improved risk reporting have resulted in stronger corporate IT governance throughout the corporation. However, many of the improvements that have been made in IT governance *are new within the past 6- 12 months* and must still pass the test of sustainability. There remains some question as to whether the long running IT risk remediation efforts that were generally complete at the end of 2006, and the IT risk policies and procedures that were implemented early in 2007 will fully remediate the ongoing risks.

Information Security - Fair

The adequacy of the corporate information security program has been an ongoing concern for many years. Remediation plans have been underway since June 2002 to address known security risks.

After a series of stops and restarts over past four years, three of the Corporate Information Security (CIS) risk remediation projects (with the exception of platform access remediation efforts for the mainframe, mid-range, and Unix/Windows servers) were generally complete as of year end 2006. However, the sustainability of those risk remediation improvements is yet to be proven. Also, new IT risks identified through business self-assessments, new technologies, ongoing internal audit reviews, and new regulations, all continue to challenge the capabilities of the corporate information security function. There have been significant improvements in the company's ability to detect, intercept, and prevent some types of information security risk. However, there is a never-ending challenge to continually improve security processes and practices. The primary reasons for the fair rating are 1) continuing platform access risk remediation challenges, and 2) demonstrated sustainability of recently completed security improvements.

Operational Risk Modeling Validation - Satisfactory

Wachovia has made significant progress in model validation. In 2006, the Model Validation and Approval (MVA) Group of Market Risk Management performed a review of the Operational Risk Model. The scope of this review was limited but the result was that the model "…is recommended for approval restricted to estimates for 2006." This review included an assessment of the model, the underlying documentation, data elements, and quantitative analysis of the model. The operational risk model was technically validated and the validation was well-documented by independent Risk Models Validation Group. The validation was performed by competent individuals in MVA that are independent of the unit responsible for developing the model (the STAR group). However, due to the limited scope of the group's work, major assumptions of the model remain unchallenged such as, fitting Pareto distribution to the "aggregate loss distribution", and granularity of the unit of measurement. The approval of the model by the independent MVA group was an action resulting from earlier examiner criticism of the program. Approval the model notwithstanding, the company continues to move forward to rethink and revise the modeling methodology. All new versions will continue to be reviewed by this committee.

Accounting/Financial Controls - Satisfactory

Policies, procedures, and controls over reconciliation and financial reporting are adequate. Management continues to strengthen internal accounting and control processes. The Transaction Risk Committee (TRC) is the liaison with the business unit CFOs and their Control Managers on financial control matters. The TRC provides the necessary oversight of the financial governance efforts. Audit recently issued a report on financial reporting which was rated satisfactory with no key issues.

The company's efforts to further develop policies more specific to transaction risk is an important part of the Sarbanes-Oxley sections 404 and 302 projects. Regulatory assessment of the SOX process found it to be a comprehensive approach toward ensuring compliance with the appropriate level of management support and line of business involvement. The trend for SOX issues continues to improve, with no material weaknesses noted for the year and a reduction of significant deficiencies from thirteen to five from 2005 to 2006. Of the five, only one is new, relating to a tax interpretation and treatment throughout the year stemming from temporary differences tied to a historical merger transaction. All of the remaining four are being remediated through the enterprise IT risk remediation projects, which have not yet been finalized.

Management has indicated they are considering combining the current Corporate Financial Controls and Finance Governance Office functions into a single unit as they feel it is natural to have the control and governance functions together. The unit would have responsibility for firm-wide financial controls/governance, financial policies, regulatory reporting and compliance, SOX processes and special projects. The nature of this combination does not give immediate rise to any regulatory concerns.

During April, 2006, the company successfully completed the conversion of legacy general ledger accounting systems to the use of Oracle Financials (a suite of general ledger accounting programs licensed from Oracle Corporation). This action brings greater consistency of process and policy across the accounting functions and improves controls.

Outsourcing / Offshoring – Fair

Wachovia has a centralized strategic sourcing/vendor management function in place that assists the line of business units in the identification, selection, and negotiation of service contracts. With more than 5,000 outsourcing agreements (vendors) in play, the responsibility for establishing service level agreements and managing the contractual relationship on a daily basis becomes the responsibility of line of business management. Unfortunately, executing that responsibility is not done consistently across all business units. Annual joint OCC/Federal Reserve examinations of Wachovia's strategic sourcing/vendor management function have found significant weaknesses over the past three years. Following each review, management has reorganized the function and hired new leadership. The latest restructuring and alignment may be the most effective as the new function appears to have the authority to resolve the issues which center around lack of a quality assurance process, and noncompliance with vendor management policies and procedures by line of business personnel.

Corporate Information Security conducts security risk assessments of key third party service providers prior to contract finalization and their results can influence the negotiations. Internal Audit looks at the internal controls after the service contract is signed, if the contract contains the standard "audit clause". Unfortunately, Wachovia acquired through past mergers several hundred vendor contracts that do not give Wachovia the right to conduct an audit or examination of the controls in place at the vendor's work site. This gap in control is being resolved as management negotiates new contracts with the required contract terms and conditions included.

Beginning in 2005, Wachovia management made a decision to begin aggressively offshoring IT application systems development and maintenance (ADM) work to three service providers (Infosys, Cognizant, and IBM) in India. Today, over 200 development projects have been offshored. In addition, 38 business processes have been offshored and are considered stable. An additional 25 business processes are in transition to GenPact locations in India and Mexico. Both of these offshoring activities are forecast to grow going forward. Also, management has outsourced personnel, payroll, and Human Resources IT support functions to Hewitt, Inc, and Hewitt has offshored part of those responsibilities to service providers in India.

In addition, management recently announced they will be opening a customer call center in the Philippines supported by their India-based service provider GenPact. The rationale for the additional capacity is internal demand/growth for call center resources. Also, management is evaluating opportunities to transition complete (end-to-end) business processes to their India-based service provider GenPact starting in first quarter of 2008.

Wachovia has created an enterprise offshoring management function to work with each of the lines of business during the identification, assessment, and transition of offshoring candidates. This team also has assigned an experienced manager to live in India and manage the relationships with the vendor GenPact while ensuring successful transitions of BPO functions. All offshoring BPO candidates are evaluated using a rigorous "tollgate" process before being selected, and once selected, the transition must pass through a series of 'tollgates" before being consider complete.

A joint 2006 OCC and Federal Reserve examination of the governance process over offshoring recommended improvements in the reporting and tracking of enterprise offshoring risk across the company. The primary recommendation was that an aggregate assessment of offshoring risk, by segment, and for the company in total, be developed and reported to senior management and the Board semi-annually. This is viewed as critical as both ADM and BPO offshoring efforts increase in number and scope across the institution. Management is considering this recommendation; however, their preference is to look at offshoring risk from the perspective of each line of business rather than across the enterprise in total.

Business Continuity Planning – Fair

Business continuity planning has been a high profile risk for several years and we have routinely communicated our concerns to executive management. During 2005, the business functions and IT rated the criticality of each application and assigned it a "Recovery Time Objective (RTO)" rating from a high of 4 to a low of 1. Systems with the highest RTO scores of 4.0 are recovered first, those with an RTO rating of 3.0 second, etc. These RTO ratings have continued to be used and are reviewed annually and updated as needed.

Business units routinely conduct a Business Impact Analysis (BIA) to assist in determining the RTO ratings. While the BCP program at Wachovia is satisfactory given a single data center disruption, the BCP program does not address a wide-scale disaster that disrupts both the primary and backup data centers simultaneously. This is a regulatory concern as both centers are located in the same city separated by a 3.5 mile distance. An out-of-region data center was completed in June 2006 in Birmingham, Alabama. During 2006, management created a technology team to develop a longer range data center strategy to resolve both the data center proximity issue and define a strategy looking out several years. The plan to resolve the current data center proximity issue and the long-term vision were both approved in 2006. Funding to begin the process of unbundling the production systems at the Silas data center in Winston-Salem, North Carolina was approved in March 2007 and work is underway to implement that plan over the next four years.

Annual testing of the Technology Recovery plan (restoration of the IT infrastructure) occurs each spring. The most recent test in April 2007 was considered satisfactory. However, the testing includes only limited restoration of databases and their applications systems, and does not include activating user recovery sites during the same integrated test period. For this reason there is risk the untested components will not perform as expected and become the weak link in a recovery event.

Insurance/Transfer Risk - Fair

Wachovia has an established Corporate Insurance function which is responsible for the design of an insurance program to mitigate certain risk financial exposure. Insurance is acquired through the utilization of a broker, or in some instances the company will self-insure certain exposure through either deductibles or the use of a captive. Coverage decisions are made based upon discussions with the individual businesses and support functions, including specific involvement of Legal. While the coverage portfolio is considered reasonable, it was noted by Internal Audit that there is weakness in the overall Corporate Insurance governance program due to a lack of formality around risk monitoring, MIS and recordkeeping systems. Additionally, while Corporate Insurance commits to acquiring coverage from industry recognized carriers, there is no formal requirement for minimum industry accepted agency ratings. Corporate Insurance acknowledges these deficiencies and has remediation efforts underway, but they have yet to be validated by Audit. *It is expected that once these enhancements are validated this rating will migrate to satisfactory.*

Wachovia has decided not to use insurance as a mitigant for operational risk. Early efforts to do so resulted in a determination that a workable methodology wound not be efficient or effective.

Internal / External Audit - Satisfactory

Overall, Internal Audit has shown improvement, and is generally considered to be an independent risk management tool upon which regulators can rely and leverage. The 2006 interagency assessment of Internal Audit resulted in a satisfactory rating, with notation that Audit Committee oversight is appropriate and Audit's stature continues to be elevated in the company. As a result, business and functional management responsiveness to issue resolution has improved. Additionally, it was noted that Internal Audit's methodology is satisfactory and reports have sound and well-supported conclusions. However, while issues are identified, at times it has appeared Internal Audit may still be hesitant to make the tough calls on risk issues or severity. Additionally, as the internal QA function takes the form of "peer reviews", the lack of pure independence of this function may impact the ability to drive desired behaviors.

In consideration of the overall improvement for Audit as a whole, slippage has been noted in the specific Technology Audit and Audit Project Office (APO) functions, most notably in their validation of the IT risk remediation projects and the Basel II RDS database project. An interim review of Internal Audit work performed in their IT risk remediation validation efforts resulted in an unsatisfactory assessment. Significant deficiencies were noted in both 1) the scope and documentation, and 2) testing, resulting in a determination that regulators could not rely upon the work performed up to that point. (Note: the regulators intend to reassess once Internal Audit closes this exercise). Additionally, Internal Audit failed to detect the deficiencies and challenges which derailed the RDS database project undertaken for Basel II compliance efforts. The APO monitoring for these two projects was ineffective and the subsequent disconnect occurred between the APO and IT Audit resources. The regulatory concern over the APO and IT Audit functions has been expressed to the General Auditor.

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Internal Audit continues to increase and upgrade staffing, resulting in a corresponding improvement in coverage, the degree of testing performed and timely completion of the audit plan. However, Audit continues to maintain only a single associate in Europe. Without domestic support, this lack of local resources may not allow for adequate coverage considering the strategic initiatives to grow the international business. Co-sourcing continues to be utilized to supplement expertise gaps, and turnover is at or below peer. The General Auditor has announced his intent to retire later in 2007. This is viewed as a positive from a regulatory perspective. The new General Auditor is the former Corporate Controller, who is well know and well respected in the company. This is viewed as an opportunity to further enhance Internal Audit's stature and effectiveness.

KPMG serves the company as the external audit group. To date, KPMG has fulfilled their roles well with no supervisory concern noted.

Legal and Compliance Risk

Inherent Risk

There are no factors below the highest level "Consumer/Commercial," "Investment Banking," and "Wealth and Investment Management" for Legal and Compliance

Consumer and Commercial Business is: Moderate

Wachovia's size (4th largest), geographic footprint, and broad product offerings continue to drive their inherent risk profile. In addition, the acquisition of GoldenWest increases their fair lending risk and adds non-traditional option arm mortgage products to their offerings. Banking businesses include private banking, online banking (4th largest), and limited sub-prime lending activities. They do not have a significant international presence and have no overseas retail deposit taking branches although they will be taking wholesale deposits in the Irish Bank (see investment banking section below for more detail).

Given some of their domestic locations are in areas considered to be high risk geographies (High Intensity Drug Trafficking Areas/HIDTAs, High Intensity Financial Crimes Areas/HIFCAs, and potential high terrorist network geographies) and they do business with NRA customers and MSBs they are exposed to increased money laundering activities.

Lending activities at Wachovia continue to be limited in sub-prime lending. They recently closed Equibanc which was a subsidiary of the bank that originated sub-prime loans primarily through broker relationships. Wachovia does offer direct and indirect auto lending to sub-prime borrowers through Dealer Services. Dealer Services includes Wachovia's legacy direct and indirect auto lending business plus WestCorp's business which they acquired in 2006. Overall, they are the 8th largest auto finance company with 47 offices serving 46 states. They have established relationships with 12,500 auto, RV, and marine dealers with an indirect loan portfolio of approximately $22 billion. It should be noted that they serve a broad spectrum of credit and approximately 20% of the indirect portfolio has FICO scores below 620. The OCC's last fair lending review in 2006 was satisfactory but it did not include the legacy WestCorp business. Their next fair lending review is scheduled to begin in June and will include the auto-finance business. Other than the auto-finance business, Wachovia does not have products that target sub-prime borrowers.

In 2006, Wachovia reentered the credit card business and is currently only marketing in their footprint. They currently have approximately $1.9 billion in outstanding balances. The OCC has reviewed their marketing materials, disclosures and terms as part of the approval process.

Although Wachovia continues to face challenges related to information security particularly with employee theft and data transportation there has been no issues with privacy compliance (501a). We continue to be notified of all breaches in a timely manner and will continue to monitor the potential impacts of their international expansion plans as well as the GoldenWest merger which increases their CA presence as well as adding another regulator to notify (OTS).

The GoldenWest merger was announced in 2006 which considerably expanded their presence in CA, added the option arm mortgage product, and added an additional regulator to deal with in the OTS. The plan is for the branch offices to be converted in 2007 to the national bank with the mortgage company remaining a thrift. The compliance implications with the merger are with fair lending. They have an underwriting process that is based on what they refer to as PACIT which is:
Property – appraisal process (only use their approved appraisers)
Assets
Credit – analyzed not scored
Income
Transaction
The process does involve underwriter judgment which could have fair lending implications as the approval/denials could be done on a prohibited basis. They also have a tremendous amount of exceptions in their approval/denial process. Historically 65 to 70% of their loan volume has been broker sold although they only take the application from

the broker and re-underwrite the client. One factor that diminishes the risk is that they do not employ risk based pricing. GoldenWest has a satisfactory rating for compliance risk management, fair lending, and flood compliance.

Given the diverse array of products offered and the amount of cross selling that occurs; conflicts of interest remain a concern.

Investment Banking is Considerable:

Wachovia continues to be a largely domestic middle market player with small activities when compared to Citibank, Bank of America and JP Morgan. Business continues to be heavily weighted towards fixed income (50% of their corporate and investment bank's annual revenue with 29% coming from structured products) with limited mergers and acquisitions, underwriting and trading activities. Private equity activities at Wachovia are also small with their portfolio totaling $1.8 billion. Although they continue to expand internationally, it continues to be in mature markets and is not substantial when compared to other larger LFI banks.

Wachovia's correspondent banking business continues to drive their investment banking risk profile as this is an area they have leading market share. They currently have approximately 800 domestic and 3500 foreign customers giving them #1 market share in Latin America and Asia and #4 market share in Western Europe. In 2006, they integrated UBOCI's correspondent banking business and plan on continuing to grow this business organically or through acquisition. This area was last reviewed in early 2006 by the OCC with our assistance with satisfactory conclusions. In addition, internal audit continues to review them annually with satisfactory conclusions.

Although Wachovia's international presence is small, they are expanding with the addition of Wachovia Bank International (WBI) which is an Irish licensed subsidiary of Wachovia Bank, NA. WBI was licensed for the European passport so they can continue to expand their structured products business. Their activities will be limited to real estate capital markets and lending activities in support of their structured products business. They will take wholesale deposits to fund asset growth but will not accept retail deposits. Wachovia Securities International Limited a subsidiary of edge corporation Wachovia International Banking Corporation will continue to be their European broker/dealer and they have recently notified us of their intentions of applying to the Japanese regulatory authorities to open a broker/dealer which will allow them to offer securities in Asia.

Reg W activities at Wachovia have been consistently around 10% of capital with a covered transaction for European Credit Management Limited at approximately 5% of capital. In early 2005, we examined Wachovia Corporation's compliance with Reg W and had two MRAs, one related to daily aggregation of affiliate activity and one related to overdraft fees. The overdraft fees MRA per Wachovia has been corrected. The daily aggregation MRA they asked for and received an extension to give them more time to implement the necessary systems. We would like to propose Reg W as an exam for our 2008 supervisory schedule.

Wealth and Investment Management is Moderate:

Wachovia Securities

Wachovia Securities is currently the 3rd largest full service brokerage firm in the country with 700 brokerage offices and 10,500 registered representatives. Wachovia Securities has three distinct distribution channels: 1) full service stand alone branch offices, 2) branches located in bank offices, and 3) independently owned introducing brokerage firms which engage Wachovia Securities for securities clearing and custody services. Full service offices are spread throughout the country with eight international offices located in five Latin American countries. Offices located in bank branches are geographically dispersed throughout Wachovia's banking footprint.

While Wachovia Securities offers a traditional set of products and services their focus is to work with "retail" clients. Given that, the product mix includes a large volume of mutual funds, fixed and variable annuities, and individual fixed income securities. While both mutual funds and annuities are not generally considered to be inherently risky from a complexity perspective, they are inherently risky from a legal and compliance perspective. These products generally require a high level of customer disclosures and can potentially expose the firm to embedded revenue sharing

arrangements. These conflicts are under increased regulatory scrutiny by the Securities & Exchange Commission, NASD, New York Stock Exchange, and various state securities regulators (collectively referred to as functional regulators). In fact, many of the functional regulators are conducting so called sweep examinations to review for these activities and typically target the largest firms. These examinations can lead to fines and/or damage to the firm's reputation.

The Latin American region poses additional inherent risks to the organization. The clientele for this region includes wealthy individuals who are generally influential in the areas they live. These individuals typically want to move their assets off-shore and conceal their identities as much as possible. The primary risks are BSA/AML related and customer identification issues.

Given the multiple regulatory agencies involved and the size and scope of the firm, Wachovia Securities is exposed to significant amount of compliance risk. The compliance department is structurally organized outside the line of business, thus providing independent representation. The compliance staff is sufficiently staffed both from a quantity aspect and from a knowledge perspective. However, increased staff turnover would pose a material risk to the organization.

Wealth Management (Fiduciary)

Fiduciary business is broken down into two groups, asset management which is functionally regulated by the SEC and personal trust which is regulated by the OCC. All fiduciary businesses are underneath Wachovia National Bank, NA. The OCC continues to rate this area moderate risk in their core assessment.

The fiduciary businesses under Wachovia are housed in two divisions: Capital Management Group which contains Wachovia Securities, CMG Insurance, Retirement Services and Evergreen Asset Management and Wealth Management Group which has approximately $71.1 billion of assets and manages an additional $211 billion for Wachovia Securities, ranks as the 4th largest wealth manager in the country. Business units under Wealth Management include Wealth Markets, Personal Trust, Wachovia Insurance Services, and Ultra High Net Worth. Customers are primarily domestic and concentrated in Wachovia's retail banking footprint, however, customers are served in 49 states. Corporate and Institutional Trust businesses were sold in 2005 and the transition was completed in 2006.

Under the Capital Management Group, Wachovia has a securities lending unit with approximately $60 billion of assets and provides securities lending activities for institutional clients located in the United States and Europe.

Evergreen Asset Management collectively manages $189 billion of assets with clients concentrated in the United States. As one of the larger business lines, it has several businesses underneath it pursuing a variety of asset management strategies. Institutional investment management is provided via separate account management while the management of mutual funds is provided through the Evergreen Funds. In addition, alternative investment strategies including hedge funds are also provided to clients. In 2006 Wachovia purchased 70% of European Credit Management which is based in London and manages approximately $26 billion. ECM provides fixed income investment management services to institutional clients.

These businesses cut across the spectrum of financial services regulation. Many of these businesses have a distinct functional regulator and a body of rules they must comply with. For example, the different regulators include the SEC, NASD, OCC, Federal Reserve, Department of Labor, and individual state securities and insurance agencies. This myriad of regulation exposes Wachovia to compliance complexities in that they must identify rules and regulations that apply and then build effective compliance systems and protocols to monitor their business activities.

The majority of the legal and compliance risks involve some form of customer disclosure documents, operational processing, document retention, suitability of products recommended, and the ability of Wachovia to execute an investment strategy based on the customers risk tolerance and investment objectives. In addition, Wachovia must satisfy BSA/AML requirements which include KYC and CIP. This has a larger impact on the Wealth Management Group since these businesses focus on individuals instead of institutions. Lastly, the overall corporate strategy within Wachovia is to cross sell products of one division into distribution channels of another division. In many ways Capital

Management Group is a "product producer" while Wealth Management Group is a "distribution platform". The cross selling of products introduces risk related to conflicts of interest. While conflicts of interest are not exclusive to cross selling arrangements they are at least magnified. The current regulatory environment is particularly focused on conflicts of interest and Wachovia given its size in the marketplace is subject to regulatory scrutiny in this area.

In 2006 the personal trust group under Wealth Management formally introduced an "open architecture" investment platform. The significance of this change is that trust will no longer exclusively recommend Wachovia's proprietary fund family, Evergreen Funds. Wealth Management has established an investment manager due diligence program to evaluate all investment managers recommended to trust clients. Evergreen Funds will now be evaluated through this same due diligence program. Wachovia has lowered any potential conflict of interest risk by moving away from exclusively recommending proprietary funds.

Reinsurance

Wachovia operates two distinct reinsurance businesses: 1) Capital Management Reinsurance Group ("CMRG") focused on reinsuring term life insurance and fixed annuities, and 2) BluePoint Re which primarily provides reinsurance on municipal and asset backed bonds. Both entities have a very small market share and contribute an immaterial amount of revenue and profits to the holding company.

These businesses operate at a "wholesale" level as opposed to a retail driven business. As an example, CMG's clients are other insurance companies (e.g. Aegon or Scottish Re) while BluePoint's clients are typically large reinsurers such as MBIA or FGIC.

The primary legal and compliance risks involve insurance related regulations. These are administered by the various states in which the insurance company conducts business. Given the transactions are between institutions, much of the insurance regulations do not apply. BluePoint Re is domiciled in Bermuda and is therefore subject to the laws and regulations imposed by the Bermuda Monetary Authority. BluePoint is prohibited from conducting any business operations within the United States.

Insurance Services

Wachovia Insurance Services, LLC ("WIS") is a subsidiary under Wachovia Corporation and managed in the Wealth Management division. WIS, as agent, provides several products to its customers including: property/casualty, life insurance, employee benefits and compensation consulting, and risk management consulting (e.g. professional liability coverage). They are the 11th largest insurance broker and the 3rd largest bank owned broker. The vast majority of WIS' customers are businesses. It is functionally regulated by the North Carolina Department of Insurance as well as other various state departments of insurance. WIS does not retain any of the insurance risk for policies sold as they are underwritten through 3rd party carriers (ex. Hartford Life, AIG, etc.). While the majority of offices are within the geographic retail banking footprint, the 2005 acquisition of Palmer & Cay provided 35 offices outside of their footprint. Although this industry has received scrutiny from the NY State AG and WIS has received subpoenas for information on their contingent commission and compensation practices, they have not had any settlements. This is not looked at by the corporation as a growth area and there are no plans for expansion.

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Risk Management and Controls

Legal and Compliance Risk Management and Controls	Risk Management and Controls												
	Board and Senior Management Oversight				Policies & Procedures	MIS & Risk Monitoring					Internal Controls & Audit		
	Board Governance Structure & Oversight	Management Governance and Oversight	Culture	Compliance Training	Legal & Compliance Policies and Procedures	Litigation RM Practices	CSA Control Self Assessments & Compliance RAs	BSMR Management Rptg	Monitoring Practices	Systems & Automation Tools	Reporting Lines	Internal Audit	Review & Testing Practices
Individual Factor Ratings	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat
Overall Rating	Satisfactory					Satisfactory					Satisfactory		

Overall Risk Management is Satisfactory

Risk management at Wachovia is satisfactory which is unchanged from 2006. There have not been any significant changes to the risk management practices at Wachovia nor has there been any exam (OCC, SEC, NYSE, NASD, and FED) or internal audit results that have shown any major deficiencies. The OCC has rated the quality of risk management as satisfactory for compliance and BSA/AML.

Two areas of concern are with CCO Bill Langley's retirement and the compliance efficiency initiative which will be occurring simultaneously. CCO Langley is expected to retire at the end of August/September while the efficiency initiative is expected to begin implementation in late 4th quarter/1st quarter.

The compliance efficiency initiative is a project sponsored by CCO Langley and authorized by Chief Risk Officer Truslow to ensure they have the most efficient and effective compliance model as well as to reduce the expected 2008 compliance budget by 15-25% ($15-25 million as compliance budget is expected to be $100 million). They continue to work on creating the revised compliance model which is scheduled to be decided in July. Currently, they have decided on a proposed organization structure which has the following reporting to the CCO:

Compliance Partners – would consist of compliance and enterprise advisors which are content experts in their functions and would provide advice/expertise and oversight for their respective areas
Privacy
BSA/OFAC Officer
Ethics
General Banking Group
International
Capital Management Group/Wealth Management Group
Corporate and Investment Bank
Compliance Centers – is considered their utility functions which are common to the entire enterprise

This organization structure adds the compliance partners, international, and compliance centers to their existing structure. The goal is to minimize any duplication or overlap and ensure that compliance employees are being effectively utilized from a corporate view not a line of business view. Senior management has made it clear they have no appetite to increase their risk profile and it is not expected to result in significant compliance staff layoffs. This is only proposed and has not been finalized so there could be changes in the above proposed structure.

Board of Directors and Senior Management Oversight is Satisfactory

Board Governance, Structure and Oversight - Satisfactory

The board of directors is independent and primarily comprised of outside directors. The only two directors that are employees of the Corporation are, CEO G. Kennedy Thompson and Ernest Rady who was CEO of WestCorp and is now Chairman of the California Banking Division and Consumer Finance Division. The board continues to approve significant policies and procedures and receives regular compliance updates through the risk and audit committees. The board has several committees including the executive, audit, risk, corporate governance & nominating, and management resources & compensation.

The audit committee is appointed by the board of directors to assist in fulfilling their oversight responsibilities for the Corporation's compliance with legal and regulatory requirements. All members of the audit committee are independent. The committee is very active and involved and receives regular updates from the Senior Risk Committee as well as the chief compliance officer. Significant issues are raised to the board's level and the board is receiving timely and accurate information.

In addition, the risk committee is also receiving regular updates from the chief compliance officer and his staff on compliance and conflicts of interest from the conflicts review committee. The committee reviews and approves all risk committee charters including the conflicts review and operational risk committees (Chief Risk Officer Don Truslow's committee which includes the Management Compliance Committee). They receive updates, as appropriate, on "the Corporation's compliance program, including the structure of the program and the assessment of risk regarding the Corporation's compliance with legal, regulatory and ethical requirements."[1]

Senior Management Governance, Structure and Oversight - Satisfactory

Senior management is informed of the legal, regulatory, and compliance matters by the chief compliance officer. The chief compliance officer notifies senior management through ad hoc meetings or through his involvement in the operational risk committee, chaired by Chief Risk Officer, Don Truslow. The operational risk committee is appointed by the Senior Risk Committee and is chartered to "…assist in the oversight of operational risk and is responsible for the Operational Risk Management Program and encouraging a risk management culture throughout Wachovia Corporation."[2] The committee is comprised of the Chief Risk Officer of the Corporation, Director of Institutional Risk Management and representatives from Loss Management, Vendor, Technology, Implementation Risk, Fiduciary, Financial, Human Capital, Business Continuity Planning, Compliance, Legal, Chief Information Officer, Internal audit, Technology Infrastructure, and Risk Policy.

The committee structure at Wachovia is satisfactory and includes compliance representation. The Management Compliance Committee is chaired by Chief Compliance Officer, Bill Langley and reports to the Operational Risk Committee. The committee oversees Wachovia's risk management practices to ensure they comply with all applicable laws and regulations issued by the various federal and state regulatory agencies. This committee is comprised of senior compliance personnel and senior leaders from key support divisions.

In addition, two committees are appointed by the Management Compliance Committee; the Anti-Money Laundering Operating Committee and the Privacy Operating Committee. The Anti-Money Laundering Operating Committee "…assists in the global oversight of effective AML risk management practices to comply with the applicable laws, rules and regulations issued by federal, state and local agencies associated with Wachovia products, services and processes."[3] The committee is chaired by the BSA Officer/AML Director and is comprised of the Compliance Risk Management AML Compliance Managers and representatives of key support units (legal, corporate communications, etc.).

The Privacy Operating Committee is appointed to "champion privacy initiatives, to provide awareness to business units of privacy issues (with a particular focus on consumer privacy issues), and to identify, address, and clarify privacy

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1 Charter of the Risk Committee of the Board of Directors, December 2005
2 Charter of the Operational Risk Committee, September 2006
3 Charter of the Anti-Money Laundering Operating Committee, February 2007

issues."4 This committee is chaired by a representative designated by the Management Compliance Committee and is comprised of compliance officers with privacy responsibilities as well as employees from key staff areas (legal, audit, corporate information security, etc.).

In addition, the Conflicts of Interest Committee is also chaired by the chief compliance officer. This committee was chartered in March of 2005 and is comprised of all line of business heads of compliance and provides oversight of the identification, recordation and resolution of conflicts of interest that exist within the Corporation. The committee has the following duties, responsibilities, and authorities as quoted directly from the Charter of the Conflict Review Committee dated December 2005:

- Provide corporate oversight for Wachovia's conflict of interest process.
- Provide for a method to regularly and systematically evaluate and address conflicts of interest across the Wachovia enterprise.
- Provide a forum for resolution of cross line of business conflicts of interest and act as a 'court of appeals' for such issues.
- Routinely review summary reports, which is provided by the business unit compliance directors.

The committee reports to the senior risk committee and the risk committee of the Board. We are scheduled to perform a targeted review of the conflicts of interest processes and oversight in the 4th quarter to determine its effectiveness.

CCO Langley announced in the 1st quarter of 2007 that he was retiring. He left his retirement date open as long as it was prior to the end of the year so there would be time to conduct a search and transition the person into the job. Deborah Davis was recently announced as his replacement starting July 9th. She brings over 25 years of compliance experience with her most recent position at Bank of America (BAC) as the head of Northeast Division Operations Executive. Prior to that position she was the Compliance Executive of BAC's Consumer and Small Business Segment and was previously the CCO of Fleet Corporation. This transition is an area of concern for us as CCO Langley has been the primary architect of their enterprise wide compliance program and has stature in the compliance community. Outside of the CCO position, the compliance risk management department continues to experience no turnover in key positions. The employees in these positions are experienced, seasoned professionals who sufficiently oversee and manage the business lines' compliance personnel. Management is aware that they will have other retirements or possible departures and have built succession plans to deal with it. The CCO of the General Banking Group is expected to retire in 2008 or 2009.

Management continues to assess any gaps or staffing needs to ensure they have the appropriate resources in place. We continue to monitor this as the compliance efficiency initiative could impact staffing.

Wachovia Securities5:

Legal and compliance executives are included in the senior management structure and actively participate on the various committees charged with overseeing the day-to-day aspects of the business. The most important committee is the Operating Committee which is composed of the most senior level managers from across all the functional disciplines across the company. The Chief Legal Officer and the Chief Compliance Officer are both members of this committee. Strategic and current issues are discussed during these meetings, thus providing a forum in which legal and compliance personnel can learn of critical issues and can participate in the dialogue of these issues.

The Compliance & Legal Committee is composed of senior business managers with the primary purpose to inform senior management of current regulatory inquiries and exams, upcoming regulatory exams, discussion of exam findings, emerging regulatory issues, and litigation and arbitration issues. This committee assists senior management in addressing compliance and legal risks in the areas of business practices.

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4 Charter of the Privacy Operating Committee, June 2006

5 Wachovia Securities was broken out separately due to the required governance processes that the functional regulators require as well as the fact that it is a joint venture with Prudential. Wachovia Securities does report through the Capital Management Group.

The Examination and Audit Committee is charged with reviewing all audit, regulatory and business review issues as addressed by both internal and external sources. All issues identified are reviewed, given a specific action plan, and then tracked through completion.

The New Product Committee has the responsibility for evaluating a new product or service for strategic fit and suitability versus the firm's goals, objectives, and target client audience. The committee will specifically identify the risks associated with a new product and how those risks will be mitigated and controlled.

Wachovia Securities has established many other committees which serve a variety of needs for the organization. These committees appear to be appropriate in not only variety of topical issues but also broad in functional management representation. These committees provide the forum in which management can both adjust business practices and also address personnel decisions to allocate appropriate staffing to critical areas.

Culture – Satisfactory

The Board of Directors and Senior Management continue to communicate the importance of compliance and ethics in their corporate culture. The compliance risk management department has an ethics hotline and enterprise ethics training to further reinforce the commitment.

General risk appetite is communicated to management through the corporate committee structure down to the business unit operating committees. Policies and procedures clearly define the risk limits of the corporation and the specific line of business. Examples include prohibited customers, countries, transactions, equity trades permitted (CIB), etc. In addition, they send out a quarterly compliance risk management newsletter to communicate any changes to risk appetite or compliance programs.

One area that Wachovia is working on is tying compliance goals to employee compensation. Currently, the performance review process does not directly incorporate compliance goals as a factor in an employee's performance review. Compliance risk management is working with human resources to add compliance goals to the performance review process. There will be one compliance goal added to all employees and multiple goals added to employees who have specific compliance duties in their job description. This is in process and is not expected to be ready until the 2007 performance review cycle.

Compliance Training - Satisfactory

All enterprise wide training for Wachovia is handled by the Compliance Risk Management department. The training program has four enterprise programs: anti-tying, AML, privacy & information security and business ethics. All customer facing employees as well as select back office personnel are required to complete AML, with all employees required to complete privacy & information security, and business ethics training annually. Business ethics was new in 2005 and was only required to be completed by managers. In 2006 all employees are required to take and complete the business ethics module. Enterprise wide training is administered via online modules through My Learning Connection @ Wachovia with an assessment at the end. In addition to the modules, Wachovia does provide face to face training as needed.

Wachovia has made a concerted effort to develop in house AML training customized to specific lines of business. An employee in the AML office has responsibility to develop and continually improve AML training. Outside of the corporate version, training modules exist for the General Bank, Capital and Wealth Management, Wachovia Securities, and Corporate Investment Bank (CIB), Treasury Services, Global Financial Institutions (correspondent banking), and the London Branch.

In addition, the AML office has developed a one day training course called the AML Academy. This is designed to supplement the required training and provide an in depth review of AML. The curriculum for the course was designed to cover similar topics to the Certified Anti-Money Laundering Specialists exam but specific to Wachovia and its businesses.

Training requirements were also implemented for employees of offshore companies Wachovia is utilizing. These employees are required to go through new hire orientation which includes AML and privacy training. These employees will also be required to complete AML and privacy training annually.

The individual lines of business are still doing their own customized training in addition to the enterprise programs. Certain lines of business have additional training modules required by their functional regulator (NASD, NYSE) that would be handled on a local level. This training is accomplished through face to face meetings or online modules.

Currently, completion of training is not tied to compensation packages of employees but rather their continued employment with the Corporation. Failure to complete training 120 days after the required completion date will refer the employee to their manager and human resources for disciplinary action which could result in termination.

In addition to required corporate training described above, Wachovia Securities is required under both NASD and NYSE rules to provide comprehensive and tailored training programs to all securities licensed employees. These programs include both industry and firm element specific issues. Results of these training programs are recorded and submitted to the NASD and NYSE. Employee compensation and performance evaluations are impacted if an employee fails to meet required training elements. In fact, the employee's securities license may be suspended or terminated if the employee fails to complete the annual required training requirements.

In addition to the regulatory required training elements, Wachovia Securities provides additional compliance training tailored to the specific needs of the organization. These programs tend to be formal and involve multiple delivery formats e.g. in-person, computer based, etc.

New Product Approval - Satisfactory

New products are approved through a committee structure for each of the five major business segments, Corporate and Investment Banking, Capital Management Group, the General Bank Group, Wachovia Mortgage, and Wealth Management. The primary focus of the committee is to identify the risks associated with a new product and how these risks will be mitigated and controlled. Each committee is comprised of the business segment chief financial officer, chief risk officer, chief information officer, compliance director, and deputy general counsel, or their designees. The committee also includes the human resources director, operational risk manager and representatives from treasury and tax as ex officio members. Market risk management and international risk management are invited if the new product is deemed to have market or international risk. The definition of new products is clearly defined as well as the process around the submission and approval of new products. Legal and compliance personnel are voting members of the committee and have ample opportunity to comment before the new product is approved. If compliance and the business line disagree, the decision is escalated to the chief compliance officer and line of business head. If disagreement continues, the chief risk officer will make the decision for the corporation. Although we have not directly tested the process and documentation, we are comfortable that it is effective and appropriate through our discussions with management.

Policies, Procedures, and Limits are Satisfactory

Legal and Compliance Policies and Procedures - Satisfactory

The policies and procedures are adequate and have shown very few deficiencies when examined by this office, the OCC, SEC, NYSE, NASD and internal audit. Corporate level compliance risk policies and procedures include BSA/AML, anti-tying, privacy and regulation O. In addition to corporate level policies, each line of business has policy and procedure manuals specific to their business. Any changes to the corporate wide policies must be submitted to the compliance risk management department for review and approval. Policies and procedures can never be below the minimum corporate standard but may need to be enhanced given risks inherent in certain lines of business. The policies and procedures are updated as necessary, reviewed by senior management, and approved by the Board of Directors. As part of their quarterly self-assessment process, line compliance is required to evaluate policies and procedures for effectiveness and new regulations which would require changes to policies. Independent of line compliance and the

quarterly self assessments, internal audit tests policies and procedures as part of their audit program.

Management Information Systems and Risk Monitoring are Satisfactory

The compliance risk management department is responsible for the risk monitoring/MIS of the corporation. Outside of the committee structure previously described, the compliance risk management department monitors business risks aligned with the corporation's lines of business which include Capital Management Group and Wealth Management Group, General Banking Group and Specialty Finance, and Corporate and Investment Banking. They also monitor corporate functional areas which include privacy, AML, ethics, and regulation O. The legal department has also assigned attorneys who work closely with compliance. This structure is independent, comprehensive, and allows for the timely identification of compliance risks and emerging issues.

Litigation Risk Management Practices – Satisfactory

Wachovia's litigation department will not provide their reserve calculation methodology as they believe this waives their attorney client privilege. Their reserve methodology does take into consideration the expected outcome with the expected dollar amount. This calculation is done with the operational risk team. The total number of lawsuits pending against the corporation has remained stable with approximately 1200 active cases and no major settlements although there are two major cases (Adelphia and Le Nature) that potentially could result in major settlements with significant press coverage.

Control Self Assessments and Compliance Risk Assessments – Satisfactory

The chief compliance officer and his direct reports (line of business chief compliance officers) compile a quarterly stoplight report which assesses and reports the major legal and compliance risks in each business line. In each business unit there are compliance professionals (business unit compliance officers) who are required to complete a quarterly self-assessment survey that assesses compliance with regulations as well as the processes in their business units. They also report current and emerging compliance risks/issues. After completion, they will submit their assessments to their line of business CCO with a risk rating (high, moderate, low). The line of business CCOs compiles them and they are vetted in the management compliance committee and input into the stoplight report.

Annually every business unit is required to assess compliance risk. Each business line compliance director is responsible for assessing the compliance issues within the businesses they are responsible for. In addition, these issues are risk ranked generally incorporating inherent and residual risk points. The compliance controls instituted are influenced by the severity of risk involved. Compliance testing frequency is also determined by the amount of risk involved compensated by the controls in place. Each compliance director has their own approach for performing the compliance risk assessment. We did review this and found that there was not a uniform rating system utilized by the various business lines and that some sub-business lines were not completing annual assessments. Compliance risk management is developing one risk assessment methodology to be used by all business lines and will include detailed procedures.

In order to assess adherence to the minimum and additional standards and increase the consistency of documentation, Compliance Risk Management implemented in mid-2005 a quality assurance ("QA") program. According to the program description, "all compliance functions within Compliance Risk Management will be subject to a Quality Assurance review. The reviews will be conducted quarterly and performed by the CRM Business Operations unit. The reviewers will focus on the quality of the compliance program and supporting documentation. After each review, a meeting will be held with the compliance manager and director to discuss the results of the review. A summary of the review will be provided to the Chief Compliance Officer for review." Thirty two separate business entities within the GBG, CIB, CMG/WMG, and AML areas are subject to review. The focus of the reviews includes assessment of four program "pillars": 1) effectiveness of the compliance risk identification and assessment process, 2) performance of scheduled reviews and surveillance activities according to established frequencies, 3) inclusion of the most significant risks in the compliance-testing program, and 4) effectiveness of the reporting and communication of testing and surveillance results to line management. We reviewed this function during our compliance monitoring and testing targeted examination and found they had only completed 7 out of 32 QA reviews and as a result suggested they reassess

the function to include an assessment of whether the function is achievable and resourced appropriately. As part of the compliance efficiency initiative project, they have suspended the program and included it in their new compliance model development. They are planning on implementing it in the first quarter of 2008 with the roll out of their new compliance model. It will be properly staffed and the reviews will be completed.

Any compliance issues that need to be tracked for remediation are input into the issues tracking database. The database tracks self-identified, internal audit, external audit, and regulatory issues/findings. Business unit compliance with compliance risk management oversight will input the issues in the database. The compliance risk management department will monitor the progress and send reminders. Issues can only be closed by a designated employee in compliance risk management and not by business unit compliance. This database is part of the operational risk management system Centerprise. This database and the processes were implemented in July of 2006 and at the time of our monitoring and testing review not all of the lines of business had entered their issues. We will follow up on this through ongoing supervision.

Board and Senior Management Reporting – Satisfactory

The stoplight report is provided to the various regulators and presented to the Operational Committee quarterly which includes the Chief Risk Officer with verbal updates provided to the Senior Risk Committee chaired by the CEO as well as the Audit and Risk Committees of the Board as necessary. In addition to the quarterly stoplight report, the chief compliance officer presents his annual report of compliance to the Senior Risk Committee and the Board of Directors. Through our review of the Corporate Board minutes as well as the various board packages, we have concluded that the process described above is working and that the appropriate reporting is occurring.

Although the stoplight report includes the AML office in its assessment, the board of directors is provided with a bimonthly update compiled and presented by the AML officer and the chief compliance officer. The report includes an update on key events internal and external, legal and regulatory matters, examination summary (internal audit, various regulators), suspicious activity monitoring, OFAC reporting, and AML training.

The General Counsel of the Legal department provides a report of litigation to the Board every two months. The report details all cases they deem "significant" along with their status and potential $ exposure. Wachovia considers three criteria in determining whether a lawsuit is "significant":

-exposure at $5million or greater

-equitable type relief that may impact business

-potential for substantial publicity (media)

He also provides an update on any regulatory actions pending against the corporation.

Monitoring Practices – Satisfactory

Monitoring practices at Wachovia are adequate and independent. We found that each line of business compliance program has monitoring in place and anything uncovered is being reported to the CCO and senior management as necessary. Our review in 2006 examined the monitoring and testing practices at Wachovia Corporation and came to satisfactory conclusions. The modest improvements we recommended were for them to use a uniform rating system and process as each line of business had minimum standards they had to follow but it did not provide a centralized process outside of the quarterly self assessments. Management did agree with our recommendations and will be implementing a uniform rating system and risk assessment process which will standardize their monitoring practices but still allow for compliance judgment.

Systems and Automation Tools – Satisfactory

Many systems and tools are utilized by the business units as well as the compliance risk management department to monitor and manage legal and compliance risk. Both groups work closely with their technology partners with internal

audit independently testing their effectiveness and alignment with policies and procedures.

Searchspace their enterprise wide automated transaction monitoring system was implemented in 2005 to improve the effectiveness of their AML/BSA monitoring, investigations and reporting. In order to maximize its effectiveness, Wachovia has dedicated a team of IT employees who continually tune the system monthly. The tuning process involves reviewing the alerts that went to investigation compared to the alerts that did not go to investigation to determine if they need to adjust the inputs. They also have discussions about the alerts generated with compliance and the Financial Investigative Unit (review Searchspace alerts) as part of their process. Searchspace and Wachovia's goal is to have 10% of the alerts going to investigation. Currently, approximately 12% of the alerts are going to investigation. In addition to the tuning process, Wachovia has contracted with Searchspace's parent company Fortner to help them ensure they have their peer groupings set correctly. In addition, they have been enhancing the system by designing business logic units (BLUs) which will generate alerts based on rules designed by business unit compliance.

Bridger GSMOS is the system they use for OFAC screening across the corporation.

The issues tracking database is described above and was implemented in July of 2006.

Internal Controls and Audit is Satisfactory

Legal and Compliance Internal Controls - Satisfactory

The system of internal controls sufficiently covers the legal and compliance risks of all business units within Wachovia Corporation. The process is independent from the business line as evidenced by their reporting lines. Internal audit coverage is satisfactory and management provides internal audit with access to information and tracks findings until completed.

Reporting Lines - Satisfactory

Wachovia's compliance function is independent of the lines of business. The Compliance Risk Management (CRM) department consists of all compliance heads of the major lines of business who report directly to the chief compliance officer, Bill Langley. The chief compliance officer reports to senior risk officer, Don Truslow who reports to the CEO. Each major line of business also has an employee from the legal department to assist them with legal, compliance, and regulatory issues.

Audit - Satisfactory

Internal audit for compliance remains satisfactory. In 2005, a compliance audit team was created with their main responsibilities to coordinate audit's three year compliance plan, oversee enterprise wide compliance audits and provide regular reporting to audit leadership and the FED/OCC. They also created centrally defined scopes for AML and Privacy audits providing the required minimum standards that are built on by the line of business audit staff. In addition, they were also involved in various enterprise wide regulatory and Compliance Risk Management audits which included business line BSA/AML segment audits (GBG, CIB, WMG, and CMG), the AML office, privacy, and compliance risk management. Other compliance audits are done by the audit team assigned to the business unit. Internal audit aligns their teams with the various business units which include Wealth Management Group/Capital Management Group, Capital and Investment Banking, General Banking Group, Risk Management, Technology, Finance, and Human Resources/Corporate Relations. Annually internal audit prepares a risk assessment for each business entity which incorporates compliance laws and regulations. They are then rated as high, medium, and low risk with the audit testing schedule determined by the rating. High risk units are audited annually, medium risk every two years and low risk every three years. In addition, the compliance audit team completes an AML risk assessment on each business entity. The same rating system and testing schedule is utilized. Coverage, frequency, scopes, and management responses are appropriate and the audit committee of the board is updated on all compliance audits. Turnover has remained low with no key departures in staffing that conducts the compliance audits.

Review and Testing Practices - Satisfactory

Compliance testing is done by the line of business compliance staff and in four distinct areas; the general banking group (GBG), Corporate and Investment Bank (CIB), Capital Management Group/Wealth Management Group (CMG/WMG), and the AML office. The testing program is derived from each of their annual and quarterly risk assessments. They assess the legal and compliance risk to the particular business unit and report the results to the management compliance committee who then decides what is included in the quarterly stoplight report. As we previously discussed in the control self assessments section above, we found that each group had in some cases a disparate rating system and approach to their monitoring and testing programs. It should be noted that we found that all of the monitoring and testing processes were working satisfactorily but we felt they would be more effective and better able to assess risks across the corporation with a uniform rating system and risk assessment process. Internal audit tests this process when they audit the compliance risk management department (CRM).

The AML Office has an AML Risk Assessment Team that is responsible for quantifying the level of money laundering risk present in the organization by evaluating the various lines of business and AML related processes. They annually assess the risk of the different business entities in each of the major lines of business. After they complete their risk assessment they test the high risk business units, high risk global issues and other areas of concern for compliance with regulatory requirements. The OCC has reviewed this team with satisfactory conclusions.

IV. Risk Matrices and Institutional Overview Appendix Items

2007 Risk Matrices

Overall

- Inherent Risk Assessment

Consolidated Inherent Risk Ratings	Inherent Risk by Risk Type													
	Credit Risk		Market Risk		Liquidity Risk			Operational Risk				Legal & Comp		
	Portfolio Characteristics	Portfolio Strategy	Banking Book	Trading Book	Market Access	Business Activities	Corporate Structure	People	Process	Systems	External Events	Cons / Com	Invest Banking	Wealth & Inv Banking
Factor Rating	Mod	Mod	Mod	Mod	Lim	Mod	Lim	Lim	Con	Con	Lim	Mod	Con	Mod
Overall Risk Type Rating	Moderate		Moderate		Moderate			Considerable				Moderate		

- Risk Management Assessment

Consolidated Risk Management and Controls Summary	Risk Management and Controls																							
	Board and Senior Management Oversight						Policies & Procedures						MIS and Risk Monitoring						Internal Controls and Audits					
	Cre	MRTB	MRBB	Liq	OpR	L/C	Cre	MRTB	MRBB	Liq	OpR	L/C	Cre	MRTB	MRBB	Liq	OpR	L/C	Cre	MRTB	MRBB	Liq	OpR	L/C
Subcomponent Ratings by Risk	Sat	Sat	Sat	Str	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Sat	Fr	Sat
Overall Rating	Satisfactory						Satisfactory						Satisfactory						Satisfactory					

Appendix Items (Business Line Management)

Divisional Management

Division	Leadership Team	Position
General Bank:	**Ben Jenkins**	**Head of the General Bank**
	Steve Boehm	Wachovia Card Services / Merger Projects
	Bob Burton	Retail Credit Products
	Tom Coley	Southern Banking Group
	> Guy Bodine	Texas
	> Robert Hoak	Mid South
	> Bob Helms	Florida
	> Bill Linginfelter	Georgia
	Reggie Davis	Northern Banking Group
	> Jim Cherry	Mid-Atlantic
	> Hugh Long	Penn/Del
	> Walter McDowell	Carolinas
	> Mike Slocum	Atlantic
	Glen Eubanks	Real Estate Financial Services
	Carol Evans	Wholesale Banking
	Bill Holt	Community Banking
	Bob McGee	Chief Administrative Officer
	David Pope	Business Banking
	Cece Sutton	Retail Banking
	Gwynne Whitley	Corporate Customer Service Excellence
	Jon Witter	General Bank Distribution
Capital Management	**David Carroll**	**Head of Capital Management**
	Dennis Ferro	Evergreen Investments
	Darryl Fluhme	Corporate & Institutional Trust
	Danny Ludeman	Wachovia Securities
	Bob Reid	Retail Investment Products
	Emile Shahadi	Finance
C.I.B.	**Steve Cummings**	**Head of Corporate & Investment Banking**
	Ranjana Clark	Treasury Services
	Michael Heavener	International
	Dave Pitelka	Finance
	Wayne Robinson	Capital Finance
	Kevin Roche	Investment Banking
	Bill Taggart	Chief operating Officer
	Ben Williams	Global Capital Markets
Wealth Management	**Stan Kelly**	**Head of Wealth Management**
	Linda Bowden	Managing Executive
	> Anne Alexander	Florida, Texas
	> Jeff Hartman	Mid-Atlantic
	> John Lotz	Alabama
	> Curt farmer	Carolinas
	> Antoinette Cooper	Atlantic
	> Sherry Pailet	Penn/Del
	> Lisa Simington	Georgia
	Morrison Creech	Credit & Deposit Services
	Anne Doss	Wealth Management Services
	Mary Mack	Wachovia Client Partnership

	Glenn McCoy	Chief Financial Officer
	Stewart McDowell	Wachovia Insurance Services
	Bob Newell	Wachovia Trust
	Dan Prickett	Managing Executive, Calibre
Operations	**Jerry Enos**	**Head of Operations, Technology & eCommerce**
	Gloria Chance	eCommerce
	Martin Davis	Corporate CIO
	Jim Ditmore	Chief technology Officer
Risk Management	**Don Truslow**	**Head of Risk management**
	Bill Dawson	Wealth and Capital Management Groups
	Jeanne Dornbos	Chief Financial Officer
	Ryan Zannon	CIB
	Adam Litke	Market Risk
	Donna Davis	Compliance Risk
	Mark Midkiff	General Bank
	Russ Playford	Credit Risk
	Yousef Valine	Operational Risk
Finance	**Tom Wurtz**	**Chief Financial Officer and Head of Finance**
	Bob Bertges	Corporate Real Estate
	Ginny Hartsema	Staff Group CFO
	David Julian	Risk Governance
	Alice Lehman	Investor Relations
	Ann Prock	Corporate Financial Services
	Pat Shevlin	Corporate Tax
	TBF	Treasury & Planning
Legal	**Mark Treanor**	**General Counsel and Head of Legal**
	Hal Clarke	Capital Management Group
	Doug Edwards	Litigation
	Donna Harris	Corporate Regulatory and Securities
	Rebecca Henderson	Credit Risk Management and Operations
	Joe Long	Wealth Management
	Mark Metz	General Bank and Specialty Finance
	Jay Powers	Corporate and Investment Banking
	Vince Randazzo	Public Policy
	Sterling Spainhour	Corporate Services
HR / Corp. Relations	**Shannon McFayden**	**Head of Human Resources and Corporate Relations**
	Jim Esposito	CIB
	David Furman	General Bank
	Larry Gilmer	Compensation & Benefits
	Peggy Joines	Wealth Management
	Hector McEachern	Corporate Businesses
	Jill Olmstead	Leadership practices
	Sharon Smart	Enterprise Services
	Doug Steele	Capital Management Group
	Scott Wells	Outsourcing
	Bob DeAngelis	Customer Analysis, Research and Targeting
	Jim Garrity	Corporate Marketing
	Ginny Mackin	Corporate Communications
	Mike Rizer	Community Relations