2006

OCC Quarterly Risk Assessment Profiles of Wachovia Corporation 2nd Quarter, 2006

Wachovia Corporation

Quarterly Risk Assessment Profile
Wachovia Corporation
2nd Quarter 2006

Holding Company No:	500609	**Last Fed Exam:**	05/15/2006
Total Assets ($B):	553.614	**RFI/C/(D):**	222/2/2
Examiner-in-Charge:	David K. Wilson		

National Bank:

Charter	**Name**	**City, State**	**Assets ($Bs)**	**C/CAMELS/ITCC**
1	Wachovia Bank NA	Charlotte, NC	504.270	2/222212/2221
23201	Delaware Trust Co NA	Wilmington, DE	0.382	2/211212/2100
22559	Wachovia Bank of Delaware NA	Wilmington, DE	2.931	2/222212/2221

Risk Assessment Summary

The overall condition of Wachovia remains sound. Wachovia's National banks remain "2" rated and the overall risk profile for the lead bank remains "moderate" with risk management rated satisfactory or better in all risk categories. During 2Q06, we changed strategic risk to "High" and the direction of liquidity risk to "Increasing". The remaining aggregate risk categories remain unchanged along with the remaining directional calls.

Management continues to take appropriate action to address our top concern – IT risk remediation. Remediation of the longstanding issues in Corporate Information Security (CIS) and Distributed Software Configuration Management (DSCM) are targeted for completion by year-end 2006. However, there will be some remaining CIS issues which were outside the original remediation scope. Another IT issue that will not be resolved in 2006 is mitigating the proximity risk between Wachovia's main data processing center and its back-up facility, both located in Winston-Salem, NC. Management provided a strategy in 12/05, but it did not meet our expectations. A dedicated project management team was recently established to address their overall data center strategy, including this proximity risk issue.

During this quarter, we changed strategic risk from "Moderate" to "High" as a result of the announced merger with Golden West Financial Corporation (GW). Wachovia's acquisition of GW, a $125B thrift with 285 branches, provides them the opportunity to accelerate their expansion plans into the growth areas of California and Texas as well as give them a national footprint. At this time, Wachovia will not be merging the two GW thrifts into the National Bank, which may complicate their ability to cross-sell products. Consumer lending is being expanded through the GW merger and the recent acquisition of Westcorp and AMNET. Wachovia's mortgage banking business is also growing, and Wachovia has re-entered the credit card business. Time and resources will be needed to effectively integrate these acquisitions. CEO Thompson has stated publicly that Wachovia does not have plans for any more "big" mergers for a "significant" amount of time as they digest their latest acquisitions.

The direction of liquidity risk was also changed this quarter from "stable" to "increasing." While liquidity remains strong, wholesale funding has increased recently due to the slowing of deposit growth and the escalation in loans as well as structure product warehouses. The recent announcement to acquire GW will also introduce new funding demands at the corporate level and we anticipate increasing usage of wholesale funding.

In addition to our top concern (IT Risk Remediation) and changes in the bank's risk profile made this quarter, we have several other supervisory concerns which are outlined below.

BSA/AML Risk - We continue to see progress in establishing more effective enterprise-wide processes in the BSA/AML area. Significant human and financial resources are being devoted to the goal of achieving sufficient mitigation of BSA/AML risk. The central corporate AML office, which includes line of business compliance liaisons and an independent risk assessment team, has been expanded. Also, *SearchSpace,* the system-wide automated function for detection of suspicious activities and transactions, was fully implemented in 12/05.

Because Wachovia has focused on the highest risks (e.g. foreign correspondence banking, MSBs), OCC and Audit findings are now generally satisfactory in those functions. However, in some other lines of business, OCC and Audit reports still reflect issues, pointing to a continued need to fully implement a consistent enterprise-wide process. Because of the nature of the products and issues involved, we feel they constitute only a moderate increase in money laundering or terrorist financing risk. Management has been responsive to specific criticisms and recommendations, and is taking action to address our concerns.

Increase in Price Risk - Expansions in trading activities, especially Structured Products and Equity Trading, coupled with staffing, systems, and technology challenges raise our level of concern. Management is undertaking a major overhaul of the trading infrastructure and maintains lower risk exposures in those books which have limited system support and MIS. In our recent review of counterparty credit processes, we identified numerous infrastructure and control function weaknesses. However, overall counterparty credit risk is low, and management has defined plans to address these weaknesses.

Increase in Credit Risk - Credit risk indicators remain extremely favorable. However, we continue to see subtle changes in the bank's and the credit market's risk appetite resulting in our 1Q06 change to the direction of credit risk from "stable" to "increasing." Management continues to expand the credit universe by relaxing underwriting standards and credit structures. Management will also implement a new scorecard based commercial risk system in 2007 that will require our close monitoring for accuracy and any systemic under-estimation of risk.

BASEL II Implementation – Wachovia continues to implement Basel II. Based upon the 01/06 OCC Gap Analysis templates, Wachovia's Basel preparations are on par with, if not ahead of its peers. They have a very active Program Management Office (PMO) and good reporting and project monitoring processes. They developed their gap analysis and implementation plan in 3Q05, and continue to revise it as regulatory guidance changes. Management continues to take steps to further strengthen the PMO process including taking steps to address our concerns from our 2/17/06 Supervisory Letter.

RISK PROFILE	QNTY OF RISK	QLTY OF RISK MGMT	AGGREGATE RISK	PRIOR AGGREGATE RISK	DATE LAST CHANGED	DIRECTION	PRIOR DIRECTION	DATE LAST CHANGED
Strategic	----	----	High	Moderate	07/10/2006	Stable	-	03/31/2003
Reputation	----	----	Moderate	-	03/31/2003	Increasing	Stable	08/13/2004
Credit	Low	Satisfactory	Moderate	-	03/31/2003	Increasing	Stable	02/06/2006
Interest Rate	Moderate	Satisfactory	Moderate	-	03/31/2003	Stable	-	03/31/2003
Liquidity	Moderate	Strong	Moderate	-	03/31/2003	Increasing	Stable	07/17/2006
Price	Moderate	Satisfactory	Moderate	-	03/31/2003	Increasing	Stable	11/28/2005
Foreign Currency Translation	Low	Satisfactory	Low	-	03/31/2003	Stable	-	03/31/2003
Transaction	High	Satisfactory	High	-	03/31/2003	Stable	Increasing	02/14/2006
Compliance	Moderate	Satisfactory	Moderate	-	03/31/2003	Stable	Increasing	08/16/2005

	CURRENT AGGREGATE RISK	PRIOR AGGREGATE RATING	DATE LAST CHANGED
BSA/AML	High	None	N/A
OFAC	Moderate	None	N/A
Internal Control	Satisfactory	-	03/31/2003
Audit	Satisfactory	Weak	08/30/2004

Risk Assessment Detail

Strategic Risk	Aggregate: High	Direction: Stable	
Type of Risk	Current Rating	Date Last Changed	Prior Rating
Aggregate	**High**	**07/10/2006**	**Moderate**
Strategic Factors	High	07/10/2006	Moderate
External Factors	High	07/10/2006	Moderate
Management, Processes and Systems	Moderate	03/31/2003	-
Direction of Change	**Stable**	**03/31/2003**	**-**

- Strategic risk is now high. Wachovia recently announced a merger agreement with Golden West Financial Corporation (GW), $125B thrift with 285 branches. This merger provides Wachovia with an opportunity to accelerate their expansion plans into the growth areas of California and Texas, as well as give them a more national footprint. At this time, Wachovia will not be merging the two GW thrifts into the National Bank, which may complicate their ability to cross-sell products.
- Wachovia continues to aggressively emphasize consumer lending businesses. Management is expanding the mortgage company business, purchased Westcorp - a large prime/sub-prime auto lender, and re-entered the credit card business. This activity coupled with the GW merger represents a high strategic risk due to the investment required to expand and merge these businesses and gain market share from competitors.
- Management has also made a shift over the last year to more aggressively compete with Bank of America and JPMorgan Chase for larger investment grade syndicated loans.
- Wachovia's late 2005 acquisition of Union Bank of California's foreign correspondent banking activities increases BSA/AML risk to the company as Wachovia now provides correspondent banking relationships to over 3,000 banks world-wide. A 1Q06 OCC review found satisfactory policies, procedures, and practices are in place to manage correspondent banking activities.
- Wachovia recently exited the embassy banking business, as HSBC Bank USA, N.A. agreed to transfer and assume servicing of Wachovia Corporation's embassy accounts.
- Wachovia's strategy calls for the growth of asset management related activities as core parts of Wachovia's diversified business model. On 7/10/06, Wachovia announced the acquisition of Miami-based US Insurance Underwriters (USIU) which provides them with their first entry into the Miami market through a well-established insurance brokerage firm specializing in property & casualty and employee benefits.
- Management also recently acquired a significant 401K recordkeeping business as part of Wachovia growth initiative for Retirement Services.
- More strategic acquisitions are expected to bolster the Company's retail sector, particularly in the brokerage area.
- Management is making reasoned decisions to exit selected business lines and redirect resources in line with their strategic plan. CMG announced late last year the sale of their Corporate Trust related business (Corporate Trust, Structured Finance, Document Custody, Transfer Agent and Broker Clearing). This provides Wachovia the opportunity to redeploy resources to higher growth areas, consistent with their strategic direction for Asset Management.
- Wachovia has also recently announced the sell of the HomEq Servicing Corp to Barclays Bank PLC as they wish to exit out of the sub-prime servicing operations. This unit was a remnant of the Money Store, Inc. Wachovia will continue to service about $100 billion of mortgage and home equity servicing rights.
- Management expects to significantly increase their use of offshore vendors to support business processes, software development, and software maintenance. Plans call for increasing their offshore FTE headcount from approximately 600 today to over 3000 by year-end 2007.
- Becoming more efficient is one of Wachovia's key strategic priorities. 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 4/30/06, Wachovia was projecting a combined year-end OER of 56.6% for 2007, short of the 52-55% Wall Street target. Executive management is reevaluating all previous outsourcing and offshoring assumptions, has doubled the 2008 savings projections from 2,500 FTEs and $35MM to 5, 000 FTEs and $70MM, and is in the process of identifying where more cuts can be made.

- Wachovia is following through with the community plan announced with the SouthTrust merger. The plan includes a $75 billion financial commitment over five years to help meet the credit needs in states impacted by the merger.
- Wachovia continues to show solid earnings, which aids in the overall "management" of strategic risk going forward.
- Wachovia continues to aggressively expand its offerings in Structured Products, as well as fixed income and equity products.
- CIB is expanding its offering of Structured Products internationally, underwriting and purchasing foreign-denominated assets and distributing to new foreign investors.

Direction of Risk – Stable

- Management is providing appropriate oversight while seeking opportunities that facilitate execution of the strategic plan.

Reputation Risk	**Aggregate: Moderate**	**Direction: Increasing**	
Type of Risk	Current Rating	Date Last Changed	Prior Rating
Aggregate	**Moderate**	**03/31/2003**	**-**
Strategic Factors	Moderate	04/20/2006	High
External Factors	Moderate	03/31/2003	-
Management, Processes and Systems	Moderate	03/31/2003	-
Direction of Change	**Increasing**	**08/13/2004**	**Stable**

- Wachovia's name and reputation in the marketplace continues to be good, as they were ranked #1 in bank customer satisfaction in a recent national survey.
- Wachovia's online banking site ranked number one in Customer Experience and Customer Acquisition Impact among prospective online banking customers. This was according to a study of customer experience on leading U.S. banking Web sites released by Keynote Systems. Also, ComScore Networks ranked Wachovia.com number one in Web site satisfaction and for the percentage of active customers who say they will recommend the site to others.
- Wachovia's reputation in the market was somewhat negatively impacted after the announced merger with Golden West Financial Corporation (GW). Following the announcement, Wachovia's stock price dropped about 13% as analysts remained skeptical of the deal.
- The cumulative effect of several high profile privacy breaches may erode consumer confidence in Wachovia's ability to exercise prudent controls over customer information. So far, issues regarding privacy notifications due to theft by employees have not unduly impacted the company. Also, the company successfully weathered the increased phishing activity brought about by the SouthTrust conversions.
- Wachovia and related subsidiaries continue to receive increased scrutiny from regulatory authorities on a variety of operating practices. Such scrutiny is consistent with the rest of the banking industry. So far, the Company's reputation has been resilient in the face of several fines and frequent media coverage.
- During 2Q06, Wachovia reached a $25MM multi-state settlement agreement with the North American Securities Administrators Association (NASAA) to settle enforcement actions against Wachovia Capital Markets LLC (WCM) involving allegations of potential conflicts of interest between the firm's research and

investment banking operations. This announcement does not appear to have had a negative impact on Wachovia's reputation in the market place.

- WMG is in the process of implementing a new platform for providing investment services to personal clients. The changes will bring several processes back into the bank charter (from the registered advisor). While the changes are seen as positive from the standpoint of independent fiduciary oversight of the process, the challenge will be in executing the implementation to avoid control gaps visible to the customer.
- Wachovia received media attention, as more specific plans were disclosed about their decision to increase outsourcing activities (domestic and foreign) and improve their overhead efficiency ratio.
- Changes in the accounting treatment for leveraged lease transactions are likely to have a negative impact on Wachovia's reputation, as they are a major player in LILO and SILO transactions.
- Wachovia recently won a diversity of jurisdiction case in The U.S. Supreme Court. Justice Ruth Bader Ginsburg wrote in the court's opinion that federal banking laws do not subject National Banks to lawsuits from every state where a bank does business.
- The Supreme Court of the United States recently announced their agreement to hear a case against Wachovia involving pre-emption. The Wachovia vs. State of Michigan case will likely be heard in 4Q06 with a decision not expected until 2Q07. .
- Wachovia is engaged tax-arbitrage financings and investments that increase reputation risk.

Direction of Risk – Increasing

- Reputation risk is expected to continue to increase for the foreseeable future. We remain confident; however, of management's ability to satisfactorily resolve the various legal, integration, and investigative issues that bear upon Wachovia's credibility and public perceptions.
- Factors adding to reputation risk include Wachovia's foreign correspondent banking expansion, the acquisition of Westcorp, which has a significant subprime auto portfolio, and recently announced merger with Golden West Financial Corporation.

Credit Risk	**Aggregate: Moderate**	**Direction: Increasing**	
	Quantity: Low	**Quality: Satisfactory**	
Type of Risk	Current Rating	Date Last Changed	Prior Rating
Aggregate	**Moderate**	**03/31/2003**	**-**
Quantity	**Low**	**11/03/2004**	**Moderate**
Underwriting Factors	Moderate	03/31/2003	-
Strategic Factors	Moderate	03/31/2003	-
External Factors	High	04/10/2006	Moderate
Credit Quality Factors	Low	02/06/2006	Moderate
Quality	**Satisfactory**	**03/31/2003**	**-**
Policies	Strong	04/10/2006	Satisfactory
Processes	Satisfactory	03/31/2003	-
Personnel	Satisfactory	03/31/2003	-
Control Systems	Satisfactory	03/31/2003	-
Direction of Change	**Increasing**	**02/06/2006**	**Stable**

Quantity of Risk – Low

- We changed quantity of risk to Low in 3Q04. Credit portfolio statistics are in line with peer banks and compare favorably to Wachovia's historical experience.

- The acquisition of Westcorp has slightly increased the quantity of risk. 2006 projected net loss levels for legacy Wachovia remain low and stable at 0.09%. Management projects full year losses for Westcorp at 1.45% which will increase corporate losses to about 0.18%.
- Consumer and commercial expected loss rates are at 0.35% and 0.20%, respectively, and remain below the 0.40% benchmark.
- Commercial credit quality remains good, but pressure from the frothy, competitive conditions is starting to weaken credit quality in the pass grades. Commercial loan risk rating exposure downgrades now consistently exceed upgrades by a ratio of 1.1-1.3 on a two month moving average.
- Commercial criticized loans remain stable and historically low at 2.33% of loans. NPAs are also stable at 0.25%.
- Overall retail credit risk is low. The consumer portfolio continues to perform well. LTV and FICO score segments remain stable. The acquisition of the higher risk Westcorp indirect automobile portfolio and the issuance of credit cards will increase the quantity of consumer credit risk slightly going forward.
- Strategic improvements in loan portfolio management should have a beneficial effect on embedded portfolio risk going forward. This includes continued use of loan sales, increased use of single name and portfolio index hedges.

Quality of Risk Management – Satisfactory

- Overall, management of credit risk is satisfactory. Management has satisfactory MIS and governance processes in place to measure, monitor and control credit risk.
- Management has prudently hired additional personnel to focus on loan portfolio management. Management currently relies on a number of tools, including borrower and industry concentrations as well as hold level limits to monitor and diversify credit risk. Management is becoming more active and implemented some cash and synthetic securitizations as well as credit default swaps to mitigate risk in the overall portfolio.
- Management is more actively monitoring commercial loans with excess exposures and implementing policies to control these exposures.
- We encourage management to continue an open dialog going forward to reconcile and resolve differences between Wachovia's economic capital framework and Basel II IRB requirements.
- The ALLL is adequate. Reserve levels increased from 1.05% to 1.07% primarily due to the inclusion of Westcorp. Management continues to provide for losses and adjust the reserve based on analysis of the risk in the loan portfolio.
- Credit Risk Review and Audit processes and procedures are effective.

Direction of Risk – Increasing

- The change in the direction of risk in the first quarter of 2006 was to recognize subtle changes in the bank's and the credit market's risk appetite prior to deterioration in lagging indicators.
- While asset quality indicators remain favorable, we see several market indicators that show credit risk increasing. These include the competitive pressure and loan migration changes discussed in the quantity of risk section.
- We have noted lending standards continuing to loosen which inherently increases risk.
- Management is also expanding the lending universe to riskier customers in several consumer-lending lines of business. This is in addition to the merger with Westcorp, a prime and sub-prime indirect auto lender, and the announced re-entry into credit card lending.
- The bank also faces several operational issues that could increase credit risk. These include the implementation of the "end-to-end" rollout, which is a change in loan approval and servicing processes in the general bank and new reduced servicing procedures for lower risk CIB customers.

Interest Rate Risk	Aggregate: Moderate Quantity: Moderate	Direction: Stable Quality: Satisfactory	
Type of Risk	**Current Rating**	**Date Last Changed**	**Prior Rating**
Aggregate	**Moderate**	**03/31/2003**	**-**
Quantity	**Moderate**	**03/31/2003**	**-**
Repricing Risk	Moderate	04/10/2006	Low
Basis Risk	Moderate	03/31/2003	-
Yield Curve Risk	Moderate	04/10/2006	High
Options Risk	High	06/08/2004	Moderate
Strategic Factors	Low	03/31/2003	-
External Factors	Moderate	03/31/2003	-
Quality	**Satisfactory**	**03/31/2003**	**-**
Policies	Satisfactory	03/31/2003	-
Processes	Satisfactory	03/31/2003	-
Personnel	Satisfactory	04/10/2006	Strong
Control Systems	Satisfactory	03/31/2003	-
Direction of Change	**Stable**	**03/31/2003**	**-**

Quantity of Risk – Moderate

- Using data as of 5/31/06, the level of short-term interest rate risk is –0.8% liability sensitive for the composite up 200 basis shift over the next twelve months policy period, compared to -1.7% liability sensitive in December 2005. The forecast for calendar year 2007 is for liability sensitivity to increase to –1.4%.
- EVE analysis is from 3/31/06. The EVE model results reflect a –10.5% change in base EVE for an up 200 basis point shock. This is unchanged from EVE results reported at 12/31/05. The main drivers behind changes in EVE exposure is the yield curve, followed by balance sheet growth and structural changes in deposit mix. No material changes in any of these drivers were noted from 12/31/05.
- Recent trends that have maintained liability sensitivity are growth in fixed rate loans (including migration of floating rate PELs into fixed rate products) and weaker outlook for deposit growth (core deposits are projected to be flat through 12/31/06).
- The loss of low cost deposits is not affecting sensitivity since most of the deposits are migrating into fixed rate CDs.

Quality of Risk Management – Satisfactory

- Management and staff resources within Treasury continue to be under pressure to perform all scheduled tasks, respond to special projects, and manage new infrastructure projects. The BancWare Convergence Implementation Project continues to have issues that need to be addressed and special projects like the Westcorp and Golden West acquisitions have consumed staff resources. Despite these issues, management continues to perform the critical interest rate risk management function and adequately monitors and manages the risk.
- BancWare was selected to replace RADAR and the new model implementation commenced 2Q04. The "full production" timeline has been extended to 3Q06, as management continues to identify critical lack of functionality issues with a few modules of the BancWare model. Management is committed to address these and other less critical conversion issues. An external project manager was recently engaged to guide the completion of the BancWare conversion, the build-out of additional application development, and the documentation of policies and procedures.
- Reportedly, a dedicated project manager for all of Treasury is in process of being recruited. This person will coordinate and direct all significant Treasury infrastructure projects.

- All material model assumption changes need to be documented and reviewed by appropriate Committees. The treatment of Goodwill and deposit life assumptions within EVE were well-documented and formally approved by ALCO. However, other recent changes have not gone through this process. This includes the process for determining the yield curve to be used in the EVE and Earnings Sensitivity model, the bank's philosophy on assuming all maturing investments or asset proxies are replaced in the earnings sensitivity forecast, and whether or not to formally include the impact of the growing Mortgage Servicing Rights book within the models. Without a well-documented measurement methodology, changes in the level of interest rate risk are difficult to assess.
- Coordination with the corporate level model validation group has begun for approval to put the BancWare model into production. E&Y has also been engaged to provide some model validation work. A "gap analysis" of outstanding model validations issues is expected to be produced. Management anticipates that conditional approval to use the BancWare model will be received in the 3Q06.
- The timeliness of deposit sensitivity data as provided by CART, and the analysis of that data by the Forecasting group, needs improvement. Resources need to be found to improve the analysis and documentation of deposit behavior along with other assumptions. Work has begun on a "dashboard" report as part of the Bancware conversion that will improve documentation of model drivers.
- Internal audit issued an audit report dated 2/27/06 of Asset-Liability Management with a Satisfactory rating. The one Key Issue was that the BancWare conversion is at risk of continued delays due to system limitations, weak project management, and staffing constraints.

Direction of Risk – Stable

- Short-term interest rate risk levels have moderated slightly and management does not anticipate any material change in the current level of short-term interest rate risk in the near future. Projected earnings sensitivity for 2007 is currently –1.4%.
- Management expects long-term interest rate risk to remain relatively stable in the near term.

Liquidity Risk	**Aggregate: Moderate Quantity: Moderate**	**Direction: Stable Quality: Strong**	
Type of Risk	Current Rating	Date Last Changed	Prior Rating
Aggregate	**Moderate**	**03/31/2003**	**-**
Quantity	**Moderate**	**03/31/2003**	**-**
Wholesale Liabilities	Moderate	03/31/2003	-
Retail Liabilities	Low	03/31/2003	-
Diversification	Moderate	03/31/2003	-
On- and Off-Balance Sheet Cash Flows	Moderate	03/31/2003	-
Net Funding Gaps	Low	04/10/2006	Moderate
External and Environmental Factors	Low	04/10/2006	Moderate
Liquid Asset-based Factors	Moderate	03/31/2003	-
Quality	**Strong**	**11/18/2003**	**Satisfactory**
Policies	Strong	06/08/2004	Satisfactory
Processes	Strong	06/08/2004	Satisfactory
Personnel	Strong	03/31/2003	-
Control Systems	Strong	04/10/2006	Satisfactory
Direction of Change	**Increasing**	**07/17/2006**	**Stable**

Quantity of Risk – Moderate

- Management has well-developed funds management practices and Wachovia has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.
- Liquidity trends show a greater reliance on wholesale funds to support increased asset levels. Core deposit growth is flat YTD 6/30/06 and projected to be flat through 12/31/06, while loan demand has grown. Wachovia is managing its increased funding needs by prudently accessing the overnight markets and issuing incremental term bank and holding company debt. Market acceptance of the bank debt was very favorable (recent issuance of Senior Bank 2-yr debt was at Libor -1bp).
- Wholesale liabilities are a significant funding source but levels are manageable. Wholesale funding grew $19B (19%) from 12/31/05 to 5/31/06 and represents 28% of total assets (TA), up from 25% at 12/31/05. Unsecured wholesale funding has increased by $22B (30%) during this time period and totaled $93B or 17% of TA as of 5/31/06. Secured wholesale funding grew by $2B (3%) during this time period and totals $63B or 11% of TA.
- Diversification and maturity structure of wholesale funds are satisfactory. The level of funding concentrations is reasonable. The most recent large provider report reflects that the top 20 largest providers funded 7% of TA with no one provider funding more than 1% of TA.
- The funding desk reports good market access. The holding company's 5-year senior debt spread continues at or below peers. Bank projections show adequate funding sources under adverse market scenarios.
- The bank has significant off-balance sheet exposures through CP backup lines, loan commitments, low floaters, tender option bond programs, and securitizations. Management adequately plans for any potential funding draws and has recently taken steps to reduce contingent liquidity exposure.
- Management has designed a flexible and comprehensive contingency funding plan. Their methodology is reasonable.
- The bank entered into a $2.5B borrowing facility with international investors 4Q05. The line serves as a potential funding source to be used as needed. It locked-in term funding and diversified the bank's investor base as well. Management hopes to diversify its investor base further by marketing Euro denominated debt issuances to the international community in the 3rd quarter 2006 along with potentially developing a Covered Bond program.
- Parent company liquidity is satisfactory. The holding company has enough liquid investments on hand to meet at least 12 months of corporate obligations.
- Wachovia projects overnight borrowing needs by year end 2006 of between $16B (assuming FHLB membership and Golden West advances rolled) and $20B (if no FHLB membership), before term issuance. Term issuance requirements by year end 2006 range from $3B to $15B, again depending on the outcome of FHLB membership and the extent to which Golden West's deposit and loan forecasts are included. Consolidated debt issuance projections for the remainder of 2006 year are $19.25B, and include issuances to not only replace maturing obligations but also meet investments in subsidiaries of $6B (cash portion of Golden West acquisition) and other funding needs.
- 3/31/06 Liquidity Summary scenario analysis reflects adequate funding sources to meet funding needs under all scenarios. Minimum level of surplus is $10B in the Scenario 4, 90 days period.

Quality of Risk Management – Strong

- Management addresses all key aspects of liquidity management in its overall risk management process. They operate under the clear guidance of ALCO and written policies and respond promptly to changing market conditions. In addition, MIS provides relevant information upon which to make sound decisions.
- Liquidity management is working with CIB management to obtain more complete CIB balance sheet financial projections. A CIB Global Markets Funding Manager has recently been appointed and will work with finance to provide information in greater detail to accurately project CIB's funding needs. We continue to encourage efforts not only specifically regarding CIB, but also with the corporate wide Enterprise Funding Initiative (EFI). A dedicated project manager for Treasury initiatives is in process of being hired and EFI will be one of the priority projects. In the meantime, work progresses on a bank funding efficiency project.
- Management satisfactorily plans for the funding needs of recently announced mergers and acquisitions.
- Management is capable and has experience raising wholesale funds in adverse circumstances. They adequately respond to changes in market conditions.
- Policies provide satisfactory guidance and limits to manage liquidity risk.

- The Liquidity Committee has approved specific limits for all large fund providers with accompanying sub-limits. Management is in compliance with the limits.
- Wachovia is tracking loans and the adequacy of their documentation necessary for securitizations and pledging requirements.
- We noted two issues requiring management's attention during our 2005 Liquidity Management and Contingency Planning review. The first issue is the need for improved parent company contingency planning. The second issue is the need for centralized oversight of global funding activities. While yet to be fully implemented, management has developed satisfactory plans to address our concerns. Completion of initiatives undertaken to address our concerns are dependent upon coordination and efforts of the recently appointed Global Markets Funding Manager and the yet to be hired Treasury Project Manager.

Direction of Risk – Increasing

- The direction of risk is being changed to "Increasing." Current trends reflect increases in the use of wholesale funds to support loan growth. In the current rising rate environment, retail deposit growth experienced over the last few years has decelerated and is projected to be flat through year end 2006. Projections for cumulative deposit growth from 5/31/06 to 6/30/07 are only $6B, while loans are projected to grow by $21B. Loans to Core Deposits has increased to 95% at 5/31/06, compared to the mid 80's percentage range throughout 2005.
- The announcement of the acquisition of Golden West earlier this year and the uncertainty regarding the outcome of FHLB negotiations have increased funding challenges. Debt issuance projections of $19.25B through the end of 2006 also increase liquidity risk.
- Fitch upgraded the long and short-term ratings for Wachovia Corporation to "AA-/F1+" from "A+/F1" on 3/21/2005. S&P placed Wachovia on "CreditWatch Positive" the day of the Golden West announcement.
- Management reports ready access to the markets and wide acceptance of their name. Access to funding at reasonable costs and maturities is anticipated to continue.

Price Risk	Aggregate: Moderate Direction: Increasing Quantity: Moderate Quality: Satisfactory		
Type of Risk	Current Rating	Date Last Changed	Prior Rating
Aggregate	**Moderate**	**03/31/2003**	**-**
Quantity	**Moderate**	**03/31/2003**	**-**
Volume of Open Positions	Moderate	03/31/2003	-
Market Factors	Low	04/10/2006	Moderate
Options Risk	Moderate	03/31/2003	-
Basis Risk	Moderate	03/31/2003	-
Concentration of Factors	Moderate	03/31/2003	-
Product Liquidity	Moderate	03/31/2003	-
Stability of Trading Revenue	Moderate	03/31/2003	-
Quality	**Satisfactory**	**03/31/2003**	**-**
Policies	Satisfactory	03/31/2003	-
Processes	Satisfactory	03/31/2003	-
Personnel	Satisfactory	03/31/2003	-
Control Systems	Satisfactory	03/31/2003	-
Direction of Change	**Increasing**	**11/28/2005**	**Stable**

Quantity of Risk – Moderate

- Price risk remains moderate relative to Wachovia's earnings and capital.
- Trading activities reflect a moderate level of risk, however, the volume and complexity of traded products continues to expand. The corporate-wide level of VAR remains moderate and stable. Year-to-date, the 1-day 97.5% confidence level VaR has ranged from a low of $13 million to a high of $22 million (corporate limit of $30 million). The average VaR has increased over 1Q06, driven by increases in warehoused assets for Structured Products and Equity trading activities. Proprietary trading is not significant and revenue is generated mainly through capturing the bid/ask spread on customer transactions. Management has identified higher risk areas including Structured Products Warehouses, Principal Investing, Short-dated Options, Equity Linked Products, and Correlation Trading.
- Although trading and risk systems remain a concern, CIBT and MRM have made substantial efforts towards upgrading systems, and mitigating risk. CIBT is implementing a multi-year plan to stabilize and upgrade trading platforms, and better align resources to support the lines of business. MRM is currently in the final stages of implementing a new VaR measurement platform and revising stress tests.
- The development flow of new products remains steady, particularly within Structured Products and Global Rates. The new product approval and fund commitment processes continues to evolve and improve.
- Wachovia posted record 2Q06 trading revenues of $995 million, driven by increased interest rate derivative volume, two large securitizations, and one-time gains. The Global Rates business posted a record quarter on derivative volumes and one-time gains on the unwinding of Tender Option Bond structures. Structured Products closed two large commercial securitizations, as well as recognizing one-time gains from warrants received in mezzanine financings. Credit Products' results were flat compared to 1Q06 due to lackluster demand and below forecast trading results. Equity Division revenues were well below forecast due to poor trading results and flat marketing.
- Counterparty credit exposure remains low, with minimal exposure to high risk entities.

Quality of Risk Management – Satisfactory

- Risk measurement and monitoring for Principal Investing is satisfactory. Controls include a risk rating system, VAR for public funds and equities, and a revaluation process. The Valuation Oversight Committee provides good oversight.
- Trading risk is monitored at appropriate levels. The independent MRM sets and monitors compliance with VAR limits, desk limits and guidelines, develops and reviews stress test scenarios, and interacts with the trading desk. MRM is upgrading its current VAR system, has added staff to better support the market risk function, and is enhancing some stress scenarios.
- Technology currently limits the effectiveness of risk management, but significant progress has recently been made to upgrade the technology platform and to ensure more robust risk reports. To deal with these limitations, risk management limits exposures in products where good reporting is limited.
- The 2Q05 Structured Products exam resulted in an overall "Satisfactory" rating. Some weaknesses were noted in the risk identification of some trading books and the CRE CDO business, controls over Risk Based Capital, corporate governance related to spreadsheets (repeat MRA), the new product process, revenue recognition in the CREF warehouse, and the need for additional limits around the MMLA warehouse (repeat MRA).
- The focus on Trading Platform IT issues including SLDC and change control, controls over systems maintained by the business line, and information security needs to continue. Enterprise initiatives are in process to address these issues and progress is noted in addressing these issues.
- The 2Q06 MRM exam resulted in a "Satisfactory" rating and management made good progress in addressing previous exam issues. The MRAs resulting from this exam are currently being finalized.
- Formal analysis of aged inventory is in place. Reserves are required as positions age. While Fixed Income non-credit reserves are held, management has concluded that equity non-credit reserves are not needed. Management plans to document their equity analysis annually.
- The backlog of unsigned credit derivative confirmations and novations has been reduced significantly. Management reports that they have exceeded the June 2006 target to reduce their backlog by 70%. They continue to work with the industry group to implement better automation and reconcilement tools. Management is now re-allocating resources to clear the backlog of interest rate derivative confirmations.
- The OCC Counterparty Credit and Hedge Fund exam resulted in a Needs Improvement rating. Several MRAs were identified on project management (repeat MRA), MIS, confirmations, credit and staffing.

Direction of Risk – Increasing

- The direction of risk this quarter remains increasing. Overall, trading activities reflect stable and growing revenue, and market risk generated from positions is moderate. Management has made substantial progress towards stabilizing and upgrading trading and risk platforms. However, many of these upgrades have yet to be fully implemented and tested for stability and accuracy. Management expects the new VaR system and major trading platform upgrades to be fully stabilized by year-end 2006.

Foreign Currency Translation Risk	Aggregate: Low Quantity: Low	Direction: Stable Quality: Satisfactory	
Type of Risk	**Current Rating**	**Date Last Changed**	**Prior Rating**
Aggregate	**Low**	**03/31/2003**	**-**
Quantity	**Low**	**03/31/2003**	**-**
Structural Factors	Low	03/31/2003	-
Strategic Factors	Low	03/31/2003	-
External Factors	Moderate	03/31/2003	-
Quality	**Satisfactory**	**03/31/2003**	**-**
Policies	Satisfactory	03/31/2003	-
Processes	Satisfactory	03/31/2003	-
Personnel	Satisfactory	03/31/2003	-
Control Systems	Satisfactory	03/31/2003	-
Direction of Change	**Stable**	**03/31/2003**	**-**

- This risk is very low. Wachovia's capital investments in foreign denominated currencies is less than $500MM. Currency Translation adjustments have been averaging under $5MM a quarter.

Quantity of Risk - Low

- See above

Quality of Risk Management - Satisfactory

- See above

Direction of Risk - Stable

- See above

Transaction Risk	Aggregate: High Quantity: High	Direction: Stable Quality: Satisfactory	
Type of Risk	**Current Rating**	**Date Last Changed**	**Prior Rating**
Aggregate	**High**	**03/31/2003**	**-**
Quantity	**High**	**03/31/2003**	**-**
Structural Factors	High	03/31/2003	-
Strategic Factors	High	03/31/2003	-
External Factors	High	03/07/2006	Moderate
Quality	**Satisfactory**	**03/31/2003**	**-**
Policies	Satisfactory	03/31/2003	-
Processes	Satisfactory	03/07/2006	Weak
Personnel	Satisfactory	03/31/2003	-
Control Systems	Satisfactory	03/31/2003	-
Direction of Change	**Stable**	**02/14/2006**	**Increasing**

Quantity of Risk - High

- Overall quantity of inherent transaction risk is high. The bank's residual risk in the key area of CIS remains elevated.
- CIS remediation plans continue through year-end 2006. Substantial remediation will result from the project; however, increased security for multiple applications running on servers, and entitlements will require management's continued attention.
- CIS Policies and Standards are being revised. This process started early 2005. In some areas the level of detail for requirements is lacking or unclear. Planned updates now go through May 2007. There is no timetable yet for the Operating Procedures.
- IT Risk Management's Risk Assessment for Technology Recovery remains at a high level due to proximity risk. The bank's original plan, delivered in late 2005, did not meet our expectations. Management is currently developing a more comprehensive plan for an overall data center strategy that will include proximity risk. A completion date for the revised plan has not been established.
- The Business Continuity Planning Group (BCPG) is still remediating issues from the "Unsatisfactory" Internal Audit report on Business Continuity Plan 2004 issued 4/21/05. The "Key Issue" of preparing comprehensive risk assessments for Business Continuity Planning (BCP) remains outstanding. The Senior Risk Committee approved the BCPG's request to extend their deadline for risk assessments to 12/31/07. Remediation was originally scheduled for completion by 12/31/06.
- The DSCM risk remediation project is complete and rated acceptable by IT Risk Management. DSCM's access controls are now a part of the ACP project that has a completion date of December 2006. Residual risk in DSCM will not be fully mitigated until the access controls are complete.
- Management continues to move IT and business processes offshore. Wachovia has offshored support for 107 applications and expects to offshore as many as 200 more by YE2006. The initial pilot phase for Business Process Offshoring (BPO) is nearing completion with approximately 250 FTEs working in India. BPO is expected to expand significantly once the pilots are completed.
- The bank completed its inventory and risk ranking of vendors. The monitoring cycle started late. Vendor risk will remain high until management completes the 2006 cycle.
- The Enterprise-wide Efficiency Improvement Program (EIP) has high public/investor visibility and is creating significant changes through twelve cross-organizational initiatives made up of hundreds of sub-projects involving process and operations redesign, site consolidation, and outsourcing. Executive management has doubled the 2008 savings projections from the outsourcing and off-shoring initiatives.
- Financial reporting controls continue to be improved to address Sarbanes-Oxley requirements. As of 1Q06, thirteen significant deficiencies remain outstanding.

Quality of Risk Management – Satisfactory

- CIS project management is satisfactory as is oversight and the commitment from executive management.
- The Internal Audit Report dated May 2006 was critical of the CIS Policies and Standards update. Gaps exist between the recommended standards and the supporting documents that provide approved practices and procedures. IT Management has replied with a delivery schedule encompassing the remainder of 2006 and extending into May 2007. Increased risk will remain until the gaps are closed. Demonstrated sustainability is not expected until 4Q07.
- The strategy presented to us in 12/05 to address the DR proximity risk issue did not meet our expectations. Dave Sakaluk has been named to head a new team charged with creating a new data center and DR strategy that will also address proximity risk. The team appears to have an appropriate methodology and approach, but actual risk reduction has been extended, and risk may increase during the transition phase.
- BCP programs are being revised to address pandemic risk.
- Internal Audit issued a "Needs Improvement" report on the Offshoring Strategy and Governance (OSG) group during 2Q06. OSG is making progress at addressing the issues from that report. OCC's review recommends an improvement in governance oversight. Initial application risk assessments should be performed to determine the suitability for offshoring.
- Vendor management controls continue to be improved. The effectiveness of new policies depends on Wachovia's successful implementation and enforcement of new standards and procedures.
- IT Risk Management needs to complete its written standards and procedures to clarify its role in the enterprise.
- Corporate-wide activities surrounding implementation of Basel II are on schedule and considered an integral part of the bank's processes for controlling transaction risk. As of June 14, 2006, Operational Risk Management determined via self-assessment that they have achieved compliance on twenty Basel II standards.
- Several new systems and enhancements are in process in CIB and Treasury, including upgrading of the CIB Trading infrastructure, MaRs (VaR system), Adaptiv (Counterparty Credit), BlackRock Alladin (Investment Portfolio) and BancWare (the new IRR system). Project management over these projects has varied and is improving as both Treasury and CIB move to a more formal project management process.
- New Product process in CIB has improved. All packages and minutes are maintained on a website and items conditionally approved have tracking to ensure compliance.

Direction of Risk – Stable

- Major projects completed on time and on budget included *SearchSpace* and Sawgrass.
- The SouthTrust conversion was completed without major issues.
- Operation Technology and eCommerce is meeting this year's efficiency goals.
- Production remains stable and generally meets availability goals.
- The bank has several acquisitions underway. These include Westcorp, AmNet, and Golden West. The recently announced acquisition of Golden West, a $127 billion savings company, will add 285 branches in five existing and five new states to the Wachovia footprint. They also have mortgage operations in 39 states. Golden West's data processing is outsourced to EDS.
- Management's plan to address proximity risk may include a significant change in their current DR processes. Risk could increase during this transition.
- Test of initial BPO pilots are progressing successfully and are well controlled. The BPO pilots are moving to Steady State, allowing business units to begin selecting additional parts of their operations for the next phase of offshoring to their BPO partner in India. Management plans to move as much as 30-40% of their application development and maintenance work to offshore vendors. Overall, offshore exposure is still relatively low.

Compliance Risk	Aggregate: Moderate Quantity: Moderate	Direction: Stable Quality: Satisfactory	
Type of Risk	Current Rating	Date Last Changed	Prior Rating
Aggregate	**Moderate**	**03/31/2003**	**-**
Quantity	**Moderate**	**03/31/2003**	**-**
Business Activity Factors	Moderate	03/31/2003	-
Noncompliance Factors	Moderate	03/31/2003	-
Litigation Factors	Moderate	03/31/2003	-
Quality	**Satisfactory**	**03/31/2003**	**-**
Policies	Satisfactory	03/31/2003	-
Processes	Satisfactory	03/31/2003	-
Personnel	Satisfactory	03/31/2003	-
Control Systems	Satisfactory	03/31/2003	-
Direction of Change	**Stable**	**08/16/2005**	**Increasing**

Quantity of Risk – Moderate

- Satisfactory, centralized, compliance risk management mitigates the inherent risk of significant noncompliance in a company as large and diversified as Wachovia.
- Wachovia's compliance with consumer protection laws and regulations, including fair lending regulations, is satisfactory. CRA ratings for both banking subsidiaries are "Outstanding."
- Compliance management has resources available to incorporate successfully the ongoing expansion of the company and of its product offerings.
- In recent years, the Board of Directors and senior management have consistently demonstrated support for the necessary compliance functions by providing needed resources.
- Acquisition of Westcorp and its banking subsidiary and Wachovia's re-entry into the credit card business will increase the quantity of risk. This is mitigated to a great extent by the company's demonstrated success in incorporating acquired institutions and by its previous experience in credit card operations.

Quality of Risk Management - Satisfactory

- Senior compliance management functions are well organized, competently staffed, and well supported.
- Compliance Risk Management continually monitors and quantifies identifiable risks.
- Management has demonstrated significant commitment to needed improvements and has been largely successful in those efforts.
- Management has shown willingness to address and cure shortcomings, whether identified internally or by auditors, regulators, or consultants.

Direction of Risk – Stable

- No changes have occurred that indicate an increasing direction of risk. Expansion of the company and its activities is taking place in an orderly and well-controlled manner.

BSA/AML	Current Rating	Date Last Changed	Prior Rating
Aggregate	**High**	**N/A**	**N/A**
Quantity	**High**	**N/A**	**N/A**
Customer Base	High	N/A	N/A
Electronic Banking	High	N/A	N/A
Large Currency or Structured Transactions	High	N/A	N/A
High Risk Customers and Business Identification	High	N/A	N/A
Foreign Correspondent Accounts	Moderate	N/A	N/A
Private Banking, Trust, Asset Management Products or Services	High	N/A	N/A
International Accounts	Moderate	N/A	N/A
Funds Transfer	Moderate	N/A	N/A
HIDTA or HIFCA Locations and Funds Transfers & Account Relationships	Moderate	N/A	N/A
Geographic Locations	Moderate	N/A	N/A
Turnover	Moderate	N/A	N/A
Quality	**Satisfactory**	**N/A**	**N/A**
Policies	Strong	N/A	N/A
Processes	Satisfactory	N/A	N/A
Personnel	Satisfactory	N/A	N/A
Control Systems	Satisfactory	N/A	N/A
Direction	**Stable**	**N/A**	**N/A**
OFAC Compliance	**Moderate**	**N/A**	**N/A**

Quantity of Risk – High

- Although significant efforts to control this risk continue, the inherent level of BSA/AML risk is high given the volume and diversity of products and services, the operating locations (domestic and foreign), and the broad customer base.
- Currency Transaction Report (CTR) back-filing issues remain outstanding as a result of poor past practices in CTR Exemption processes.

Quality of Risk Management – Satisfactory

- Wachovia's BSA/AML compliance program satisfies regulatory requirements, and provides for: 1) a system of internal controls to ensure ongoing compliance; 2) independent testing of BSA/AML compliance; 3) a BSA compliance officer; and 4) training program for appropriate personnel.
- Significant steps have been taken to strengthen the BSA/AML internal audit function.
- The central corporate AML office, which includes line of business compliance liaisons and an independent risk assessment team, has been expanded.
- SearchSpace, the system-wide automated function for the detection of suspicious activities and transactions, was fully implemented in December 2005.
- There is evidence that additional efforts are needed in some lines of business to ensure the optimum level of consistency in risk assessment and management.

Direction of Risk – Stable

- Due to Wachovia's significant focus the highest risk areas (e.g. foreign correspondent banking, MSBs), OCC and Audit findings are now generally satisfactory in those functions.
- While the acquisition of foreign correspondent banking business from Union Bank of California in 2005 increased risk, a majority of the acquired accounts are held by existing customers of Wachovia, mitigating this risk somewhat.
- The sale of Embassy Banking accounts to HSBC reduced AML risk.
- Reasonable processes and procedures are in place to help ensure that mergers and acquisitions, including growth through the West Coast expansion, are incorporated without increased risk to the AML program.

Internal Control	Current Rating	Date Last Changed	Prior Rating
Aggregate	**Satisfactory**	**03/31/2003**	**-**
Control Environment	Satisfactory	03/31/2003	Weak
Risk Assessment	Satisfactory	08/13/2004	-
Control Activities	Satisfactory	03/31/2003	-
Accounting Information and Communications	Satisfactory	03/31/2003	-
Self Assessment & Monitoring	Satisfactory	12/10/2004	Weak

Quality of Internal Controls – Satisfactory

- Overall, Wachovia's system of internal controls provides reasonable assurance that business units achieve their stated objectives and produce reliable financial reports.
- The control environment is supported by a well-conceived committee structure that allows the Board to properly oversee risk taking and control activities. The tone at the top is continually reinforced via the Audit Committee, Senior Risk Committee, and Corporate Governance and Nominating Committees, among others. The operational risk manager has expanded education, awareness and communication activities in 2006, including implementation of an internal Operational Risk website.
- A strong risk-assessment program stems from several sources including Audit and Risk Management departments. During 1Q06, OCC examiners reviewed Audit's risk assessment process and found that it produces reasonably accurate and consistent risk ratings across Wachovia's audit universe. Also, on an ongoing basis, the OpRisk division maintains a corporate-wide risk assessment database to monitor operational risks including (1) control self-assessments completed annually by each business unit, (2) risk-control workshop results, (3) Sarbanes-Oxley testing results, (4) internal and external operational loss data, and (5) anti-money laundering risk profiles.
- We continue to observe a high frequency of audit reports highlighting non-material deficiencies in basic control activities. For instance, 18 of 51 internal audit reports issued to date for the 2006 audit-cycle cite weaknesses related to reconcilements, segregations of duties, and other basic control activities. In addition, KPMG identified 23 management control deficiencies related to financial reporting processes as part of its year-end 2005 SOX testing. We will continue to reassess the significance of these findings, including the potential for material error, via quarterly meetings with the SOX team and monthly meetings with Internal Audit.
- Consistent with improvements in the internal audit program and Sarbanes-Oxley program, Wachovia has become more effective at identifying and resolving internal control deficiencies. The SOX program and methodology is continuing unchanged and is considered effective. During 1Q06, the SOX team (1) tested 1,290 significant controls, (2) implemented lessons learned sessions with the objective of improving testing efficiency, and (3) conducted initial integration due diligence testing at Golden West.

- Financial reporting controls continue to receive intense scrutiny via the bank's Financial Governance Office and its Sarbanes-Oxley implementation project. As of 1Q06, 13 significant deficiencies remain outstanding consisting of access control concerns (8), other IT (2), spreadsheet controls (1), derivative trade confirmations (1), and PEL interest accrual reporting (1). In most cases, inappropriate access to financial systems has been removed. Closure of the access control deficiencies, however, will depend on testing performed in 2006 to determine segregation of duties for individuals granting access and authorization processes.
- Information Security - Information security continues to be a top internal control concern. Access control deficiencies and other information security-related issues have been cited in 10 of 51 internal audit reports issued during the 2006 audit-cycle. The frequency of these findings contributed to a "Needs Improvement" overall audit rating for the Corporate Information Security audit issued 5/3/06. Also, the Internet Online Banking area received an "Unsatisfactory" rating on 6/6/06 audit's lowest rating. Weakness in the bank's overall information security controls is also highlighted in the bank's Sarbanes Oxley testing, with KPMG tracking 23 access control related deficiencies as of 12/31/2005. In addition, 8 access control deficiencies are being tracked internally. It should be noted, however, that substantial remediation has occurred which has led to a decrease in the risk of unauthorized access.
- The Efficiency Improvement Program continues to create significant organizational change via twelve cross-organizational efficiency initiatives made up of hundreds of sub-projects involving anything from process redesign, to site consolidation, to outsourcing. Although our May 2006 review of the EIP revealed no matters requiring attention, we recognize that the scale of process redesign efforts presently underway increases overall operational risk.
- Our recent investigation of Wachovia's handling of a depository relationship with a third party payment processor raised concerns regarding the adequacy of risk management in this area. We feel that risk management did not appropriately escalate issues related to the questionable activity in these accounts.

Audit	Current Rating	Date Last Changed	Prior Rating
Aggregate	**Satisfactory**	**08/30/2004**	**Weak**
Audit Committee	Satisfactory	08/30/2004	Weak
Management & Processes	Satisfactory	06/29/2005	Weak
Audit Reporting	Satisfactory	08/30/2004	Weak
Internal Audit Staff	Satisfactory	06/29/2005	Weak

Internal Audit – Satisfactory

- Internal audit remains "Satisfactory". Audit Committee and audit leadership continue to elevate Audit's stature within the company whereby audit identified control weaknesses are receiving more timely and appropriate management attention.
- The Audit Committee is effective, and provides appropriate direction and oversight. Audit Committee reporting has improved over the past year as it focuses more on risks facing Wachovia, management's plans and time frames for corrective action, and Audit's independent assessment of management's progress in addressing the risks.
- Audit management and staff are capable and focused on continuing to improve the overall quality and effectiveness of the audit function.
- A sound audit program is in place that includes coverage audits, project monitoring, and continuous monitoring of risk and strategic changes within the audit universe. More comprehensive audits are being conducted, and Audit remains on target to meet their 3-year audit coverage plan in 2006.
- Audit reports and work papers are satisfactory, and reveal sound conclusions with ratings well supported.
- Audit staffing levels and expertise has improved substantially over the past several years. As a result, coverage audits have significantly increased along with the depth and breath of the testing performed.
- IT audit and the compliance audit functions have improved and are now considered satisfactory. The "new" programs for both of these areas were fully implemented over the past year resulting in increased coverage and more detailed testing.

- Audit needs to have a program to ensure effective coverage of complex modeling activities throughout the corporation. This program should evaluate modeling integrity and reliability on an ongoing basis, with resources that have these required quantitative skills. Audit leadership is in the process of developing a plan to address this need.
- An independent audit needs to be performed periodically of key processes within the Corporate Fraud Investigative Services (CFIS) unit, a division of Audit. Previously Audit has performed these reviews despite the fact that this unit reports directly to GA Schild. We have no concern with the reporting structure, per se. And while we also found Audit's scope to be adequate and issues appropriately surfaced, we do have a concern with Audit reviewing their "own" work. Audit leadership has recognized this issue and has agreed to outsource these activities in the future. Accounting firms are being interviewed, and the specific scope and proposed testing are being finalized.
- The Enterprise Technology (ET) unit continues to work on reducing their report issuance timeframes in order to be more in line with internal standards. Through the first 5 months of 2006, ET reduced their average report issuance to 47 days, from 54 days in 2005. Audit's stated benchmark is 30 days. Audit leadership is in the process of identifying the root cause and establishing an action plan to address this concern.
- Audit issues are validated within 180 days of management's declaration that they are "closed." From an industry perspective, this 180-day time period is longer than most peer banks that we surveyed. Most peers regularly perform audit validation work within 90-120 days following management's corrective action. Audit leadership is talking with their peers to better understand how other companies are conducting audit validation work and to identify ways to streamline the process.
- Audit should continue to strive for a higher and sustained level of performance. This would include being more consistent and proactive in (1) the identification and escalation of enterprise –wide issues to senior management and the Audit Committee, and (2) making the "tough" calls when management decisions or inaction expose the bank to higher or unacceptable levels of risk.

Other Information

Management

Management continues to effectively govern the enterprise. CEO Ken Thompson provides the appropriate leadership, and the executive management team has the ability to effectively manage through industry changes and economic cycles.

Wachovia's Board of Directors is active and continues to demonstrate their ability to plan for and respond to risks that arise from changing business conditions and new products and services. The board recently changed their board election rules for 2007, which will require the annual election of each of the board members.

Management continues to take appropriate action to address supervisory concerns. Management's Senior Risk Committee (SRC) provides proper oversight of the formal remediation processes for our top supervisory concerns. In the past year, SRC's effectiveness has been enhanced with their increased oversight of all risks in the bank including credit, market, operational, liquidity and compliance.

During 2Q06, management decided to revamp their project review processes to improve their overall governance around project funding and project portfolio management. The Implementation Risk Committee and the Enterprise Project Review Committee were disbanded, and a new Central Investment Review Board was formed, which will have enterprise-wide responsibility for funding and project portfolio management. The first meeting of the Central Investment Review Board was held on 7/6/06, and plans are for this committee to meet on a monthly basis. In order to promote similar governance processes within the lines of business, management will be establishing LOB Investment Review Boards in 3Q06. One of the goals of this new governance structure and process is to establish and oversee a "gated" funding plan whereby, funds will be approved and distributed in phases to ensure that projects continue to show a strong business case before any additional funding is provided.

Wachovia's corporate governance structure and practices are considered satisfactory. There are no systemic areas of concern, although the IT and CIB/Treasury business lines governance processes have areas which need improvement. IT Risk Management needs to more clearly define roles and responsibilities and should enhance risk management reporting. Management is addressing this by developing IT risk management policies, procedures and standards. In the CIB/Treasury area, more consistent compliance with enterprise-wide model validation processes is needed. Management is in the process of reassigning and reorganizing the model validation function. Corporate validation will now fall under Market Risk Management. Currently, policies are being reviewed and supplemented, staffing is being assessed, and model inventories are being updated.

Management and the board have established appropriate policies and controls addressing the bank's operations and risks. Wachovia has a sound control environment. Wachovia's internal controls are satisfactory and promote effective operation and reliable financial and regulatory reporting. Wachovia's SOX program is effective and has recently completed its 2nd year of sustainability. Wachovia's Internal Audit program has also significantly improved over the past several years and now provides an effective independent control function to safeguard assets and ensure compliance with laws, regulations, and internal policies.

Earnings

Wachovia's earnings remain satisfactory for the quarter. Wachovia reported GAAP earnings of $1.885 billion for an EPS of $1.17, and operating earnings, which exclude merger-related and restructuring expenses, of $1.9 billion for an EPS of $1.18. These results exceeded consensus Wall Street expectations of $1.16 per share for operating earnings. Second quarter earnings (both GAAP and Operating), were up 7% and 5%, respectively, quarter on quarter, and 13% and 10%, respectively, from 2Q05. Wachovia benefited from strong trading and principal investing results, as well as the full quarter effects from the Westcorp merger. Higher than normal principal investing gains ($186MM as compared to $100MM in 1Q06) assisted Wachovia in exceeding Wall Street expectations by 3 cents this quarter.

All business segments reflected good earnings growth, with the exception of Wealth Management who continues to be negatively impacted by the change in business model enacted in the past year. Capital Management and Wealth Management moved to a more combined delivery model (new investment platform – managed fee business) and consolidated their research departments. As a result, the costs of these changes are being reflected in Wealth Management, while the increased revenues are being shown now in Capital Management. Wealth Management's insurance commissions and trust and investment management fees are lower, and thus resulting in a 9% reduction in revenues as compared to 2Q05.

Wachovia's core earnings remain fairly stable for the quarter as loan and deposit growth, excluding benefits from Westcorp merger, increased 2% and 1%, respectively. Wachovia's net interest margin continued to decline (3 basis points) as a result of the yield curve environment. However, management stated that without the full Westcorp results this quarter, Wachovia's margin would have declined between 8-9 basis points. Management expects the margin to continue to decline for the remainder of 2006.

Strong credit quality continues to positively impact Wachovia's earnings. Despite the increase of Westcorp assets, net charge-offs were only $51MM after they had several large telecommunication recoveries this quarter. NPAs were at record low level of .25%. As a result of the continued strong credit quality indicators, Wachovia's provision for loan losses was only $59MM, as compared to $61MM in 1Q06.

Non-interest expenses increased 1%, quarter on quarter, and 12% as of 2Q05. Included in the increase was $30MM in expenses related to efficiency initiative efforts, mostly severance and occupancy expenses, and $12MM in credit card expenses as they build out their new credit card platform. Management continues to take steps to reduce the increase in expense growth. Wachovia's OER ratio has dropped to 57.03%. Management has stated that they remain on target to meet their target range of $600MM-$1 billion run rate savings by year-end 2007. However, at this time it is more likely that they will be in the lower end of the range in 2007 before meeting the $1 billion mark in 2008. Management continues to identify new initiatives that will assist them in meeting these goals.

Management continues to anticipate solid earnings for the remainder of 2006 as credit quality indicators remain favorable. Management is anticipating EPS in the range of $4.70-$4.75 for 2006. These estimates do not reflect the effect of the proposed Golden West merger, which is expected to close in 4Q06.

Capital

Wachovia remains well-capitalized. The Tier 1 capital and leverage capital ratios at June 30, 2006 were 7.77% and 6.57%, respectively. Earning forecasts for 2006 appear achievable. Future capital levels are expected to be negatively impacted by the merger of Golden West in fourth quarter 2006 and the new accounting requirements for leveraged lease transactions in first quarter 2007. Additionally, there is some uncertainty regarding the impact of the new accounting requirements which occur at year-end for post retirement benefits. Like many other banks, Wachovia will need to record an additional liability, with a corresponding entry to other comprehensive income (a reduction of equity). Banking regulators will need to rule on whether regulatory capital must also be reduced by the amount of this accounting entry. Although the above items may be significant, capital ratios are projected to remain at "well-capitalized" levels. If necessary, the bank can restrict stock buy backs and dividend payouts to maintain capital at appropriate levels. Management continues to make progress in implementing new capital systems for the Basel II implementation.

BASEL II Implementation

In 2/06, we issued Supervisory Letter WB-2006-07 which concluded that the bank's Basel planning process was satisfactory. The Basel PMO has provided a satisfactory response to the Matters Requiring Attention in the Supervisory Letter which included: (1) increasing Board oversight; (2) better defining the validation process; (3) enhancing the quality assurance process; and (4) ensuring a comprehensive gap resolution process. Basel project teams continue to re-visit the bank's implementation plan and project interdependencies to meet the parallel year start date, and Audit remains active in monitoring the Basel PMO. We will continue to communicate extensively with management as the regulatory guidance and the final rule are issued.