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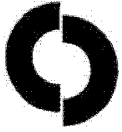
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The information contained in this report is based on the books and records of the bank, on statements made to the examiner by directors, officers, and employees, and on information obtained from other sources believed to be reliable and presumed by the examiner to be correct. It is emphasized that this Report of Examination is not an audit of the bank and should not be construed as such. This examination does not relieve the directors of their responsibility for performing or providing for adequate audits of the bank.

Each director, in keeping with his or her responsibilities both to depositors and to shareholders, should thoroughly review this report. Subsequent to this review, the directors should sign the form attached to this report. If the Board is not in substantial agreement with the contents and conclusions of this report, a request should be made promptly for a conference between selected members of the Board and officers of the bank and representatives of the deputy comptroller to review these matters.

Name of Bank: Wachovia Bank, N.A.  
City, State: Charlotte, North Carolina  
Charter No: 1  
Exam Cycle Ending: June 30, 2008

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Comptroller of the Currency  
Administrator of National Banks

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August 4, 2008

Board of Directors  
Wachovia Bank, N.A.  
301 South College Street  
40<sup>th</sup> Floor, Suite 4000  
Charlotte, NC 28202-0005

Dear Board Members:

This Report of Examination (Report) summarizes conclusions reached by the OCC's examination staff from supervisory activities conducted for the Wachovia Corporation's lead national bank charter, Wachovia Bank, National Association (Wachovia). The time period covers July 1, 2007 through June 30, 2008, with financial information as of June 30, 2008. It also covers our CAMELS/ETCC ratings and Risk Assessments. During the past year, we conducted 36 examinations of specific bank activities and processes, with conclusions and recommendations communicated to management in individual Supervisory Letters. We also performed discovery work and ongoing supervision related to various lines of business and processes. While these activities did not result in Supervisory Letters, they influenced our overall conclusions and will assist us in appropriately targeting areas for future work.

In addition to this Report, we prepared separate Reports for the company's three other national bank charters (Wachovia Bank of Delaware, National Association; Delaware Trust Company, National Association; and Wachovia Card Services, National Association.) These legal entities facilitate general banking, trust activities, and credit card lending. Our assessments of these activities are contained in those Reports, and they influence certain ratings for the lead bank as some supporting activities are conducted from the lead charter. This Report contains conclusions with regard to our overall Risk Assessment and extends to findings related to company-wide processes that support activities in all charters.

The overall condition of Wachovia has deteriorated during the past year. As a result of the significant deterioration in the residential real estate and commercial real estate portfolios and

the continuing market disruption, Wachovia's earnings, present and future, have been severely impacted. Financial markets remain unstable, and credit losses are expected to increase substantially over the next year. In addition, recent regulatory and legal matters have also become public, which have further tarnished Wachovia's brand name and reputation and have highlighted weaknesses in Wachovia's Board oversight and management of risk.

As a result of the deteriorating condition of the bank, the overall composite rating for Wachovia Bank, N.A. has been downgraded to a "3." Management, Asset Quality, and Earnings are all rated "3" with Capital, Liquidity, and Sensitivity to Market Risk remaining "2" at this time. While the bank remains "well-capitalized" for Prompt Corrective Action purposes, asset quality deterioration and significant operating losses have put a strain on the bank's capital levels. Similarly, while the bank remains liquid, potential funding sources have become more restricted. Given market and bank volatility, the earnings, capital, and liquidity ratings continue to be evaluated and could be downgraded if further financial deterioration occurs. Additional details concerning the CAMELS ratings are provided in the *Ratings* section of this Report.

Because of the downgrade to a composite "3," we expect Wachovia's Board of Directors to enter into a Memorandum of Understanding with the OCC. Additionally, as will be explained in a forthcoming letter, since the bank is subject to the limitations on controlling or holding an interest in financial subsidiaries set forth in 12 U.S.C. § 24a and 12 C.F.R. § 5.39, its composite and management "3" ratings will require that the bank enter into an agreement with the OCC pursuant to 12 U.S.C. § 24a(e)(2 and 3) and 12 C.F.R. §§ 5.39(j)(1)(ii) and (iii).

Many of Wachovia's recent difficulties have stemmed from questionable strategic decisions and incomplete due diligence activities. In addition, the Board and management sometimes did not proactively respond to changing market and business conditions. This has led to high risk in several areas of the bank including the legacy Golden West portfolio, the residential commercial real estate portfolio, certain parts of Corporate and Investment Banking (CIB), and certain activities in Treasury and Balance Sheet Management. Wachovia lacked an atmosphere of credible challenge when the Golden West acquisition took place. When evaluating strategic decisions or new initiatives, the Board and management need to ensure that each initiative receives a thorough vetting and is adequately challenged to ensure that all risks are identified, evaluated, and addressed. In addition, the Board needs to clearly define the company's strategic direction and the Board's overall risk appetite. Appropriate policies, procedures and practices should be in place to provide clear guidance regarding acceptable risk exposure levels, and strategic decisions should be consistent with achieving this desired risk profile.

It is also incumbent upon the Board to ensure executive management builds a strong management structure that promotes a corporate culture that is balanced and transparent, instills discipline and accountability, and emphasizes strong risk management practices. Management of risk throughout Wachovia continues to be one of our top supervisory concerns. The market disruption, concerns identified during recent examinations, and several of the regulatory issues being investigated have highlighted the need for Wachovia to strengthen the identification, escalation, prioritization, and management of risk. This includes enhancing a business culture that promotes accountability and clearly establishes a risk framework where the line of business owns and manages the risk with the Risk Management Unit having clear authority and

responsibility to approve, disapprove, or escalate risk. Disagreements between line of business management and risk management should be escalated to the Chief Risk Officer.

The significant deterioration in the legacy Golden West portfolio, and its associated Other Real Estate Owned, is the primary reason for the decline in overall asset quality for Wachovia. The commercial residential building portfolio and general weaknesses across all of the portfolios have, to a lesser extent, also contributed to the deterioration. Loan losses and nonperforming assets (NPAs) have reached levels that are of concern. The rate of increase is rapid, and there are no signs of stabilization. Management in the near term needs to continue to focus on credit risk reduction and, on a longer term basis, improving credit risk aggregation and portfolio risk governance.

With the continuing deterioration of Wachovia, management has enacted its Liquidity Crisis Management plan and is taking steps to build liquidity to meet potential stress events. Because of the heightened sensitivity of the market to Wachovia's financial condition, more formal liquidity and capital planning processes are needed. These programs are critical to ensure that Wachovia is proactive in addressing potential events which could impact its' viability.

Recently, the Board acknowledged many of these weaknesses, and has taken a more active oversight role at Wachovia. The Board hired a new CEO on July 9, 2008; contracted with an outside consulting firm to assist in an evaluation of Wachovia's risk management practices, culture, and corporate governance structure; tightened underwriting and eliminated the negative amortization feature for the Pick-a-Pay product; and commenced actions to generate, protect, and preserve capital. These actions, as well as, recent actions taken to hold people accountable represent positive steps toward improving Wachovia's overall condition. Further details about the corporate oversight/management of risk, credit risk, and liquidity and capital planning issues are discussed in the ***Matters Requiring Attention*** (MRA) section of this Report. The Board needs to ensure that these issues receive appropriate attention and actions taken to fully address them are clearly outlined in the response to this Report.

Regulatory and legal matters continue to also negatively impact Wachovia's reputation in the market. On April 24, 2008, Wachovia Bank, N.A., through its Board, entered into a Formal Agreement (Agreement) with the OCC to improve internal controls and risk management systems related to the bank's acceptance of remotely created checks (RCC's). This includes provisions for consumer education, and further requires the bank to reimburse consumers harmed by the bank's relationships with certain telemarketers and third-party payment processors that used RCC's. To date, Wachovia is making progress in complying with this Agreement, and management has provided all required submissions in a timely manner. The OCC plans to evaluate this information for its sufficiency and quality during a targeted examination scheduled to commence August 4, 2008. Further detail addressing Wachovia's compliance with this Agreement is provided in the ***Appendix*** of this Report. In addition to this regulatory matter, Wachovia continues to be subject to other legal and regulatory investigations that may expose the bank to additional reputation risk, compliance risk, civil money penalties, and possible criminal/civil litigation. These include the municipal bid rigging matter, Auction Rate Securities issues, and Anti-Money Laundering (AML) concerns related to Wachovia's former relationships with certain *casas de cambio*.

In addition to the items highlighted above, we have supervisory concerns in several other areas. These include Basel II implementation, Bank Secrecy Act (BSA)/AML activities, IT Risk Remediation, and the use of Spreadsheets and End-User Computing Tools. Management continues to be responsive to these issues, and action plans are either in place or in process of being developed to address our concerns. Details about these are provided in the *Other Supervisory Concerns* section of the Report.

In addition to the CAMELS rating changes, the overall risk profile of Wachovia has now increased to “High”. Strategic, Reputation, Credit, Liquidity, Price, Transaction and BSA/AML risks are all considered “High”, while the remaining risks (IRR and Compliance Risks) remain “Moderate” and Foreign Currency Exchange risk remains “Low.” These risk ratings are designed to provide a forward-looking view of the institution’s risk profile. A detailed listing of the bank’s Risk Assessment ratings, along with a description of recent changes, is located in the *Risk Assessment Summary* section of this Report. We continue to closely monitor all of these risk categories for additional changes.

We extend our thanks to management and staff for their openness and ongoing cooperation. We welcome your questions and comments regarding this Report and other supervisory communications. Please provide a written response by September 30, 2008 to this Report that confirms Board and management’s commitment and action plan for addressing the Matters Requiring Attention.

Sincerely,

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David K. Wilson  
Examiner-In-Charge  
Large Bank Supervision

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Michael L. Brosnan  
Deputy Comptroller  
Large Bank Supervision

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## **MATTERS REQUIRING ATTENTION (MRA)**

### **Corporate Oversight/Management of Risk**

Concerns identified during recent examinations, market disruption events and regulatory investigations have highlighted the need for greater oversight and direction from the Board as well as improved risk management across Wachovia. Many of Wachovia's problems in the past year have resulted from questionable strategic decisions including the acquisition of Golden West, the expansion of risk within the Bank Owned Life Insurance (BOLI) portfolio, and the banking of questionable telemarketer related entities. These decisions were not thoroughly vetted to identify and evaluate present and future risk prior to their approval. In addition, the Board and management have been slow to react to changing market and business conditions. Underwriting and default management deficiencies within the legacy Golden West portfolio were not addressed in a timely manner until they manifested themselves in increasing problem assets. This resulted in an even higher risk profile for Wachovia. Going forward, the Board and management need to be more proactive in their oversight of risk. The Board also needs to clearly define the company's strategic direction and the Board's overall desired risk profile.

Wachovia's present risk culture and decentralized approach lends itself to an environment with inconsistent identification, escalation, prioritization, and management of risk. Wachovia needs a strong risk culture that enforces strong accountability and ensures management makes all risk-taking activities transparent to appropriate risk and control partners. Risks should be comprehensively analyzed and escalated appropriately. In addition, management of risk should be conducted at the line of business level, and the Risk Management unit should have clear authority and responsibility to approve, disapprove, or escalate risk.

Treasury and Balance Sheet Management is a specific area that needs a robust risk management function. Additional details are provided elsewhere in this report.

In response to the continuing deterioration in the bank, management has recently implemented its Liquidity Crisis Management plan and is taking steps to build liquidity to meet potential stress events. Because of the heightened sensitivity of the market to Wachovia's financial condition, these programs are critical to ensure that Wachovia is proactive in addressing potential events which could impact the bank's viability. The Board needs to ensure that management continues its course to refine and formalize these plans as well as provide regular updates to the Board. We discussed needed enhancements in the Liquidity section below.

In summary, the following actions are needed:

- Develop a clearly defined strategic plan;
- Develop a clear, well-defined desired risk profile with clear risk tolerance levels;
- Develop a formal action plan to address how you will achieve the desired risk profile;
- Develop a uniform process for thoroughly vetting strategic decisions;
- Define clear roles and responsibilities for line of business management and Risk Management personnel that promotes accountability;
- Adopt a consistent process for identifying, prioritizing, and escalating risk issues;

- Enhance risk reporting to ensure it quantitatively measures and monitors risks so risks can be meaningfully aggregated at the corporate level;
- Institute a robust Treasury Risk Management function;
- Continue to enhance formal liquidity management processes; and
- Formalize stress testing processes for capital.

### **Credit Risk**

Management in the near term needs to continue to focus on proactively seeking opportunities to reduce credit risk. Problematic strategic decisions in the past have put management in a tenuous situation – its immediate missions are to timely identify problem assets and improve asset quality in a poor economic and illiquid environment. To this end, we acknowledge that management is taking action by tightening underwriting standards, standardizing qualification and documentation requirements for residential loan workouts, and investigating alternatives to sell or not renew loans. Management should place particular emphasis on loans over the established household level limit. Specifically, management should:

- Develop aggregate reporting that tracks this risk reduction and establishes goals and asset quality targets for the short (6 months) and intermediate term (12-24 months).
- Continue and accelerate actions to meet the above targets, including:
  - Working with troubled residential real estate borrowers while also adhering to safe and sound banking practices that include timely and proper recognition of nonaccruals, Troubled Debt Restructurings, and losses; and
  - Proactively reducing long-term risk via refinances of Pick-a-Pay mortgages into amortizing product using proprietary or government-sponsored programs and/or asset sales.
- Develop improved credit risk aggregation and portfolio governance processes and more clearly establish tools to enforce credit risk tolerances across the corporation, including:
  - Formalizing warehouse/pipeline risk limits relative to capital or earnings at risk;
  - Coordinating hedges across business areas;
  - Increasing servicing and collection efforts; and
  - Adhering to house limit hold levels.



## OTHER SUPERVISORY CONCERNS

In addition to the concerns highlighted above, we also have supervisory concerns in the following areas:

**Basel II Implementation** - The overall Basel program remains “deficient” (red status) with various work streams either behind schedule or lacking approved integrated work plans. Retail modeling remains behind schedule, and management needs to build more models than they previously anticipated. The Risk Data Strategy (RDS) has missed target completion dates, and Regulatory Capital Calculations and Reporting has key dependencies on projects which are behind schedule.

The recently completed Horizontal IRB Review indicates that the bank’s progress toward Basel compliance lags its peers with respect to the Retail work stream. While the bank’s progress is also slow in some areas of Wholesale, most of the other mandatory banks are also experiencing similar difficulties regarding Basel compliance. Wachovia continues to make progress in the Basel AMA areas. However, management is actively developing and implementing changes to incorporate a consistent methodology for the identification, reporting, and aggregation of Business Environment Internal Control Factors (BEICF), as well as enhanced operational risk reporting and a “new” capital model that includes multiple units of measure.

Currently, the Basel Project Management Office (PMO) is coordinating efforts around the creation, review, and approval of the Regulatory Plan, which must be approved by the Board of Directors by October 1, 2008. The plan will include objective, measurable milestones, and will describe the resources that the bank has budgeted and that are available to implement the plan. Management’s present timeline calls for the start of parallel run on October 1, 2009. Basel II Final Rule requires mandatory banks to start their parallel run no later than April 1, 2010, to ensure that they commence a first floor period start date by April 1, 2011. The Basel program’s history is one of not meeting target dates. This is a source of concern as the bank’s current schedule leaves limited cushion for additional slippage in key projects.

**BSA/AML** – The Wachovia BSA/AML compliance program satisfies regulatory requirements prescribed in 12 CFR 21.21; however, certain aspects of the program need further attention. These areas include CIB AML processes and the need to complete the Currency Transaction Report back-filing project. We continue to review Wachovia’s activities related to certain *casas de cambio*. Although Wachovia exited the foreign currency exchange business, an investigation is underway for potential money laundering activities and the OCC has started an examination to review related controls and monitoring processes. We will continue to review other aspects of the BSA/AML program including the oversight changes that are underway in terms of the reporting structure, management, and risk assessment for BSA/AML activities.

**IT Risk Remediation** - While IT risk remains high, management continues to make good progress in addressing the various IT Risk Remediation projects for access control deficiencies, data center proximity risk (DCPR), and vendor management. Management is in the process of

resolving risk exposures for developer's access to distributed production servers, and is executing Phase II of the DCPR strategy. This includes application analysis, build-out of the third data center, and testing of scenarios and critically bound applications. Remediation efforts for both access and DCPR are expected to extend into the fourth quarter of 2009.

The Global Supplier Management & Outsourcing/Offshoring (GSMO) Group continues to strengthen governance and internal controls over the vendor management program. These efforts are expected to continue throughout 2008. GSMO has developed a risk-based vendor management program leveraging off Wachovia's Operational Risk process. Enterprise-wide vendor management will remain a vulnerable function until all aspects of the governance and internal controls structure are in place and vendor managers are fully trained.

***Spreadsheets and End-User Computing Tools (EUCTs)*** – During late 2006, we identified the need for an integrated and effective enterprise-wide governance plan to identify use of spreadsheets and EUCTs activity. Since that time, management has developed a Draft Enterprise Spreadsheet Governance Rollout Plan. Management has determined the highest risk areas, and plans to roll out a solution to those higher risk areas in 2008. These areas include Treasury and Planning, and Corporate Accounting and Reporting. CIB continues with its roll out of the Prodiance tool and has made good progress on implementation. The OCC will continue to monitor the CIB and Enterprise-wide solutions for controlling spreadsheet risk.

**RATINGS\***

	<u>Exam Date</u>	<u>Prior Exam</u>	<u>Prior Exam</u>
	June 30, 2008	June 30, 2007	June 30, 2006
<b>Composite Uniform Financial Institution Rating</b>	3	2	2
<b>Component Ratings:</b>			
<b>Capital</b>	2	2	2
<b>Asset Quality</b>	3	2	2
<b>Management</b>	3	2	2
<b>Earnings</b>	3	2	2
<b>Liquidity – Asset/Liability Management</b>	2	1	1
<b>Sensitivity to Market Risk</b>	2	2	2
<b>Uniform Rating System for Information Technology</b>	2	2	2
<b>Composite Uniform Interagency Trust Rating</b>	2	2	2
<b>Uniform Interagency Consumer Compliance Rating</b>	2	2	2
<b>Community Reinvestment Act Rating</b>	Outstanding	Outstanding	Outstanding

\*Refer to the OCC Bank Supervision Process Handbook issued September 2007 for a description of the CAMELS and Specialty Ratings.

**Composite Rating – 3**

The overall condition of Wachovia Bank, N.A. has deteriorated and exhibits weaknesses in Management, Asset Quality, and Earnings that are of supervisory concern. The overall composite (“CAMELS”) rating is a “3” under the FFIEC Uniform Financial Institutions Rating System,<sup>1</sup> and the overall risk profile is “High.” Management of risk throughout Wachovia needs improvement, and the Board and management have been slow to react to risks that have arisen from changing market and business conditions. Asset quality is less than satisfactory, and credit risk is high as a result of continued deterioration over the last 12 months. Earnings are poor, and the trend has been negative. The bank’s capital ratios are acceptable at this time. However, Wachovia now has limited options for raising capital, if needed. While liquidity levels remain sufficient, liquidity risk is “High” as funding pressures have persisted and are likely to increase as a result of the on-going market disruption and investor concern. Wachovia’s sensitivity to market risk remains acceptable.

<sup>1</sup> A 3 rating indicates some supervisory concern(s) in one or more of the component areas. The concern(s) may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Banks in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Also, significant noncompliance with laws and regulations may exist. Risk management practices may be less than satisfactory relative to the bank’s size, complexity, and risk profile. These banks require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these banks.

**Capital Rating – 2**

At this time, capital is rated a “2,” and the bank is within the “well-capitalized” level for Prompt Corrective Action (PCA) purposes. Wachovia’s capital levels are projected to remain adequate through year-end 2008 and into 2009. However, the financial condition of the bank has deteriorated and it is difficult to determine when the main driver of poor earnings, the bank’s residential credit portfolio, will stabilize. If financial deterioration continues and other capital preservation efforts are not successful, the capital rating will likely be downgraded during the third quarter. Options to raise capital are more limited because they would likely be highly expensive and/or dilutive, and investors may have less of an appetite for more Wachovia debt or equity. In an effort to preserve capital, the Board further cut dividends in July 2008, to \$0.05 per share which will save approximately \$700 million in capital per quarter. Other major venues to maintain capital ratios include reducing expenses, deferring capital consuming initiatives, restricting asset growth, or selling assets. Management is estimating that these strategies will benefit Tier 1 capital by more than \$5 billion by year-end 2009. In the past two months, management approved a plan to reduce total risk-weighted assets and balance sheet usage by \$20 billion by year-end 2008. Project Stanley was recently implemented to address capital. Formal reporting to the Board on this project is needed. We also continue to closely monitor projected earnings and credit loss levels and have asked management to submit a more formal capital projection with appropriate stress scenarios.

Although capital levels declined in 2007 and first quarter 2008 due to asset write-downs and credit losses, Wachovia Corporation bolstered capital levels by issuing \$15 billion in Tier 1 eligible instruments since December 2007. Wachovia Corporation’s Total capital and Tier 1 capital at June 30, 2008 were approximately 12.9% and 8%, respectively. Bank Tier 1 capital stands at 7.2%, leverage capital at 6.26%, and Total Capital at 11.46%. Wachovia’s capital levels were projected to deteriorate through year-end 2008 and into 2009; however, the company further cut the dividend in conjunction with the 2Q earnings announcement, which should improve projected ratios.

The Board needs to ensure that a formal stress testing process is implemented to identify potential drains on capital levels and the avenues available to address these concerns. Although capital models are updated monthly based on balance sheet forecasts, management has not prepared ongoing stress scenarios to determine risk to capital levels if the corporate forecast is not realized. Stress scenarios should include unexpected growth in assets and off-balance sheet contingencies as well as decreased earnings. This analysis should also contain trigger levels for additional capital issuance, cutting common dividends, and stopping or slowing asset growth.

**Asset Quality Rating – 3**

Asset quality is less than satisfactory and rated “3”. This represents a downgrade from the previous “2” rating. Asset quality measures deteriorated significantly over the last 12 months and credit risk continues to increase. Aggregate credit risk is “High,” with the quantity of risk rated “High” and the quality of risk management rated “Satisfactory,” although weakness exist in the risk management function. The direction of risk remains increasing. The aggregate and quantity of risk ratings represent downgrades from the previous “Moderate” level rating.

All asset quality metrics continue to worsen as they are coming off the pristine levels of recent years. Continued deterioration is most evident in consumer mortgages, residential builders and indirect autos, with other portfolios showing milder weakness. While current lagging indicators appear manageable, losses, delinquencies and criticized assets are projected to reach levels that are concerning. Quarterly loan losses have gone from 0.14% as of June 30, 2007 to 1.1% as of June 30, 2008. Based upon preliminary numbers, Criticized and Classified asset commitments for the bank now represent approximately 49% and 33% of Tier 1 capital plus the ALLL. NPAs also show clear increasing trends since year-end 2006. They have gone from 0.18% as of year-end 2006 to 2.44% as of June 30, 2008. NPAs are forecast to increase into 2009 and are currently projected to exceed 4% at that time.

The level of the ALLL is adequate at this time. Management appropriately increased the ALLL from 1.04% as of June 30, 2007 to 2.24% as of June 30, 2008, given the increasing portfolio risk. We will conduct a detailed review of the ALLL level and the effectiveness of the methodology in the current stressed environment starting in August 2008. Management has already made changes in the retail loss modeling in an attempt to better capture inherent risks in the legacy Golden West portfolio. Management needs to maintain a conservative approach when establishing the ALLL level given continued deterioration and difficulty in forecasting defaults and loss severities.

Three related factors have caused a dramatic worsening in asset quality. First, the significant decline in the consumer housing markets caused losses in the Pick-a-Pay portfolio and residential building related commercial portfolio. Second, the 2007 credit market disruption caused significant market losses as assets (leveraged loan/CMBS warehouses, subprime securities, etc.) were written down. This disruption also required the bank to add several assets to the balance sheet that were originally intended for distribution or off-balance sheet vehicles. Lastly, the general economic slowdown has caused a milder deterioration across virtually all other loan portfolios.

### ***Retail Credit***

The general issues described above have had a greater negative impact on the retail portfolio. Retail asset quality is less than satisfactory, has deteriorated substantially in the past year, and has shown no signs of stabilization. Aggregate retail credit risk is “High” as compared to “Moderate” one year ago.

In the past year, total consumer NPAs have increased from \$1.7 billion or .66% of total consumer loans at June 30, 2007 to \$8.5 billion or 3.11% at June 30, 2008. Quarterly consumer loan losses similarly increased from \$122 million or 0.29% of total consumer loans for the second quarter of 2007 to \$854 million or 1.26% for the second quarter of 2008. Consumer NPAs and loan losses are forecast to further increase well into 2009.

The legacy Golden West’s Pick-a-Pay portfolio (and its associated Other Real Estate Owned) is Wachovia’s largest class of distressed assets. It constitutes a highly disproportionate share of

consumer NPAs and loan losses. This portfolio, which is concentrated heavily in the distressed California and Florida markets, has deteriorated much more rapidly than projected. As a result, management is frequently revising its projected credit loss and NPAs levels upward and very large provisions are being made to cover these losses. For the first six months of 2008, Golden West net charge-offs were \$748 million compared to only \$5.7 million for the same prior-year period. As of June 30, 2008, Golden West NPAs were \$7.1 billion compared to only \$1.2 billion a year earlier. Latest projections indicate that Golden West NPAs will likely be at least \$12 billion, or 10% of the portfolio by year-end 2008. The Bank holds about 46% of the legacy Golden West portfolio on its books, and the Bank's portfolio represents about 50% of the NPAs and losses. Many of these loans had sub-prime characteristics with FICO scores below the industry accepted sub-prime level of 620. In addition, low documentation loans were not properly controlled. These practices were at odds with the largely conservative practices of legacy Wachovia, but management did not address them until it was obvious that the Golden West portfolio was highly problematic.

As discussed earlier, the corporate organization lacked an atmosphere of credible challenge when the Golden West acquisition took place and shortly thereafter. By necessity, this credible challenge aspect is now present. Consumer risk management is now taking the lead in making residential real estate loss mitigation programs uniform across the company. Risk management has also tightened underwriting practices across the mortgage portfolio including the Pick-a-Pay products. Similarly, management was conservative when they began treating some skip-a-pay credits as nonaccrual loans. We support this treatment until greater controls and transparency is implemented around this process. All of these actions are considered as positive steps to improve the quality of the residential real estate portfolio. Please refer to the Asset Quality MRA for detail on actions that management should continue to stress.

The indirect auto portfolio is of secondary concern. Wachovia acquired this portfolio in 2006 from Westcorp. While the business is profitable and coincident indicators are within industry norms, the portfolio is showing signs of deterioration. Full year 2008 losses are projected to be \$660 million, or 2.6% of outstandings with many being sub-prime customers. Production of new loans has exceeded expectations for much of 2008, which is contrary to industry trends. Our concern is that management has not integrated the indirect business into the corporate risk structure. All other retail credit businesses have a separate risk function outside of the lines of business that report up to Chief Consumer Risk Officer Nole. However, the indirect operation was permitted to keep the legacy structure of Westcorp where the risk function is imbedded in the line of business. As part of the outside consultant's review of overall risk management, they should address whether this risk management structure is a sound method to control risk.

### ***Commercial Credit***

Commercial credit quality remains satisfactory. Clear weaknesses are present in the residential building related portfolio within Real Estate Finance (REFs), but the remaining portfolios show a milder deterioration. The general bank and investment bank portfolio asset quality levels, excluding housing related REFs, are returning to historical norms and remain manageable at this time. Despite current satisfactory performance, large potential risks to asset quality exist in the

income-producing commercial real estate and leveraged loan portfolios. These incremental risks combined with existing consumer and residential building weakness would severely stress capital and earnings. Management is taking actions to mitigate this risk by continuing to sell leveraged loan exposures and conducting an in-depth review of the commercial real estate portfolio.

As noted above, management needs to continue to focus on credit risk aggregation and portfolio governance processes across the corporation. As an example, household level exceptions consistently showed an increasing trend over the last 2 years and warehouse/pipeline risk limits were not always formalized or measured relative to capital or earnings at risk. Also, hedging activities provided mixed risk mitigation because they occur in a number of areas and were not always well-correlated to specific risks. Management also needs to continue to focus on risk rating accuracy and the need for heightened servicing. These are critical for accurate and timely risk identification.

As noted above, commercial credit weakness is centered in residential building related borrowers. The dramatic slow down and price reductions in consumer housing is causing rapid deterioration in this \$12 billion portfolio. Our examination of this area in first quarter 2008 and the recent shared national credit examination confirmed continued significant deterioration in these credits, which are difficult to workout. Over 34% of this portfolio was criticized as of April 2008. NPAs have increased above 11% and losses are projected to exceed 2.5% in 2008.

The market disruption caused management to keep or bring approximately \$25 billion in assets with credit risk onto its books. These assets were from off-balance sheet structures (Atlas, VFCC) or from areas that historically originated assets for distribution (leveraged lending, CMBS, structured products). At this time, credit risk in these assets is satisfactory, and returns are generally good since most assets were booked at a discounted value. However, some assets that were transferred from available for sale (AFS) to held for investment, especially in the “opportunistic portfolio”, are showing continued stress with approximately \$460 million in temporary impairments.

Management reduced exposures to AFS assets in various real estate warehouses and leveraged loan mandated commitments. These exposures are now less than \$6 billion from a high of approximately \$33 billion in June 2007. The significant write-downs taken on these assets were generally a result of the market’s perception of the risk/return rather than deterioration in the underlying fundamentals of the company. Hedging activities off-set some of these losses but were not always correlated well. Underwriting on these assets was weak which presents a potential future asset quality issue if the economy continues to slow. Many of these credits were underwritten based on aggressive growth projections and hold levels now significantly exceed house limits.

Lastly, the bank’s potential “indirect” exposure to monoline insurers warrants continued monitoring. Management is working on methodologies to attempt to quantify this potential

exposure. As a result of this work, management has established reserves which we will review in more detail at our upcoming counterparty credit examination.

### **Management Rating – 3**

Recent market events as well as legal and regulatory issues have raised concerns with the quality and effectiveness of Wachovia's management team, as well as Board oversight. As a result, management is being downgraded from a "2" rating to a "3" rating. Corporate oversight and management of risk, as detailed in the *Matters Requiring Attention* section of this Report, need strengthening. Questionable strategic decisions and insufficiently proactive oversight has led to many of Wachovia's problems. In addition, the Board has not provided clear guidance regarding acceptable risk exposure levels, and has not ensured that appropriate policies, procedures and practices have been established.

Corporate governance structure and practices are in the process of being strengthened. While the overall corporate governance committee framework is appropriate, execution remains an area of concern. Management of risk needs improvement. In particular, management should strengthen the identification, escalation, control and measurement of risk including having a clear risk culture where management of risk is performed at the line of business level with the Risk Management Unit having clear authority to approve, disapprove, or escalate risk. While the Risk-related Corporate Governance Initiative (RRCGI), which commenced in 2006, addresses some of these concerns, additional efforts are needed. Management has engaged an independent consulting firm to evaluate Wachovia's risk management and corporate governance practices.

While the overall internal control environment remains satisfactory, deterioration has been noted in recent months as operational losses have increased. Significant and unexpected losses have occurred in the past year due to process breakdowns identified during the market disruption. In addition, legal and regulatory matters have increased substantially, thus exposing the bank to possible future losses and increased litigation costs.

Wachovia's internal audit function remains satisfactory. The Audit Committee and new Chief Auditor, David Julian, have continued to elevate Audit's stature within Wachovia. Chief Auditor Julian has articulated a "new" vision for Audit that provides for a more flexible program that reacts to current market conditions and looks more horizontally across the organization to identify risk governance and control weaknesses. Management continues to take timely and appropriate action to address the internal control weaknesses identified by Audit.

The compliance management process includes substantial resources allocated to implement and monitor compliance with the various laws, rulings, regulations, policies and procedures. Compliance policies and processes are sound. While the overall BSA/AML compliance program complies with regulatory requirements, BSA/AML related incidents such as the *casas de cambio* case, continue to occur that raise some concerns over the program's overall effectiveness.



**Earnings Rating – 3**

The earnings component continues to warrant a “3” rating. Wachovia earnings have been poor over the past two quarters as the market disruption and significant deterioration in the housing market has continued. Earnings have steadily deteriorated over the past four quarters with Wachovia suffering significant losses in the last two quarters. As of June 30, 2008, Wachovia reported an operating earnings loss for negative earnings per share of \$1.27. Year-to-date operating losses have totaled \$3.4 billion. In addition, the bank took a \$6.1 billion charge for goodwill impairment during second quarter 2008. Management’s forecast of a rebound in earnings has thus far not materialized as loan delinquencies and charge-offs continue to increase and provision expense remains elevated. Provision expenses are expected to remain elevated throughout 2008, at a minimum.

Management has aggressively taken large provisions in excess of charge-offs the last two quarters in an effort to stay on top of potential credit losses, most of which are from the Pick-a-Pay portfolio. Management changed their retail loss modeling as they build their allowance in anticipation of higher expected losses.

Market disruption losses continue to negatively impact Wachovia’s earnings. Year-to-date, market disruption related charges (excluding provision expenses) have totaled \$5 billion mostly centered in CIB trading and in the parent segment.

The overall quality of earnings varies based on the segment. Unfortunately, poor earnings in the CIB and mortgage area have overwhelmed the profitable units. On a positive note, with the exception of these two areas, segment earnings in Capital Management, Wealth Management and the General Bank Group (excluding Golden West) have remained fairly stable. Wachovia has launched several initiatives in June with a goal of building and preserving liquidity. While these actions are necessary, they will likely result in lower forward-looking earnings performance. Latest earnings projections for full year 2008 indicate that Wachovia will experience an operating loss of approximately \$2.7 billion. However, earnings projections to date have been unreliable and have frequently been adjusted downward as the bank’s condition has deteriorated. The earnings rating may further be downgraded if positive earnings are not restored in the near future.

**Liquidity Rating – 2**

Liquidity continues to be rated a “2”. The market disruption and continued earnings deterioration have reduced funding opportunities and raised funding costs for Wachovia. While Wachovia’s liquidity is presently adequate, the market is focused on the company’s condition and potential events, which could trigger a loss of confidence in the bank and further reduce funding opportunities. Some large fund providers are already limiting Wachovia exposure. All major credit agencies have downgraded Wachovia's credit rating one notch as expected following the earnings announcement on July 22, 2008. We are closely monitoring the liquidity position and the appropriateness of the current liquidity rating in light of projected losses, credit downgrades and future potential loss of funding availability.

Liquidity management during the disruption has thus far been satisfactory. Management has conducted formal scenario analyses to assess funding needs under two increasingly severe credit downgrade scenarios. These scenarios reflect significant funding needs and management has instituted appropriate plans to address these needs. Additionally, to ensure that Wachovia's stressed liquidity needs are met, management has activated the bank's contingent funding plan and is taking steps to build liquidity to meet potential stress events. Actions taken to date include: initiating new retail and wholesale deposit promotions, placing hard caps on assets of various business lines to more carefully management balance sheet growth and redirecting all investment pay downs into U.S. Treasury securities. Additionally, management has established a centralized communication response team to deal with inquiries from interested parties, including its retail branch management team and the media.

Because of the heightened sensitivity of the market to Wachovia's financial condition, these programs are critical to ensure that Wachovia is proactive in addressing potential events which could impact the bank's viability. The Board needs to ensure that management continues its course to refine and formalize these plans as well as provide regular updates to the Board. Needed enhancements are discussed in the next paragraph.

Over the past year, the Treasury Funding staff was able to adapt the existing Stress Scenarios and Contingency Funding identification process to account for the current market disruption. Wachovia has historically used this more informal communication system to identify potentially non-legally binding liquidity demands from affiliates and subsidiaries. However, Asset Liability Management Committee (ALCO) now needs to be more formalized and integrated into liquidity management policies. Additionally, management needs to revise the description of stress scenarios to reflect changes recently made to incorporate experiences and observations from the market disruption. While some affiliates and subsidiaries of the holding company operate under a self-funding model, reputation risk may require the parent company or the bank to support them under extreme circumstances. Management needs to ensure that Stress and Contingency funding planning processes are comprehensive and identify entities in the consolidated company that could place a demand on parent or bank funding. Assessment of the funding risk should include contingent liabilities that are legally binding, as well as products or lines of business that the entity would support during a crisis because of reputation risk.

Liquidity risk is "High" as the on-going market disruption has reduced availability of unsecured term funding and raised funding costs. The market's appetite for securitizable assets has significantly diminished. As a result of the reduced availability of funding in the term debt market and loan growth, which has exceeded core deposit growth, wholesale funding levels have increased. Funding gap risk is high, as under a severe scenario, significant gaps could occur. Management is taking steps to address these gaps.

Wholesale funding reliance represents 32.7% of total assets as of May 31, 2008, up from 30.8% at year-end. Wholesale funding providers are currently reviewing, and cutting, in some cases, or limiting their exposure to Wachovia. Wachovia has active borrowing relationships with three FHLBs which represent a concentration, and in aggregate they fund 7% of assets. Wachovia's

retail deposit base has been stable and remains a strong source of potential liquidity; a recently announced retail deposit promotion targeting CDs and money market deposits has been successful.

Investor concern is evidenced by Wachovia's credit default swap (CDS) spreads, which remain higher than many of its peer banks, and its depressed stock price. As of quarter-end, Wachovia 5-year CDS traded more than 70 basis points (bps) higher than Citibank, which was its closest peer. Cash bonds spreads have risen both on an absolute and relative basis; as of mid-June, the option adjusted spreads for various tenors of senior holding company debt was trading at 100 – 175 bps higher than JPMorgan Chase and Bank of America.

### **Sensitivity to Market Risk Rating – 2**

A rating of “2” remains appropriate. Interest rate risk remains “Moderate.” Short-term earnings sensitivity has increased to a moderate level over the past year, but is expected to remain stable for the near term. As of June 30, 2008, the level of short-term interest rate risk is relatively low at -1.7% liability sensitive for an up 200 basis point ramp over the next twelve months. The rolling 12-month view shows sensitivity migrating to -3.4% (liability sensitive) by second quarter 2009, before replacement of discretionary hedging decisions. Long-term interest rate risk, as measured by EVE (Economic Value of Equity), has remained at moderate levels since March 2005.

Although risk management is considered satisfactory, some control systems continue to have weaknesses. Model validation is an area which continues to need attention. Model validation has not always been completed prior to model implementation, as management has not historically integrated model validation into its project planning. Management is implementing a project to convert EVE modeling to BancWare and model validation is part of the project planning. All material model assumption changes need to be documented and reviewed by appropriate Committees.

Management continues to be able to achieve the bank's targeted net interest income (NII) levels without exceeding policy limits for interest rate risk (IRR). They have identified the scenarios where they are most vulnerable and execute hedges when the benefits outweigh the cost of hedging the risk. A volatile yield curve and resulting shifts in new loan production mix continues to challenge the Forecasting area's modeling and hedging skills. The addition of the Golden West merger along with the volatility of retail deposit growth and increases in fixed rate loan products has added significant complexity to the risk management process.

Trading activities, in aggregate and quantity, reflect a high level of sensitivity to market risk. Origination volumes have slowed dramatically and outright positions, while volatile, have slowly reduced. Hedging has not been as effective as the basis between instruments dislocated. Life to date market disruption losses are approximately \$5 billion, but were significantly less in the second quarter 2008. Trading Risk remains centered in Extend Stay Holdings (ESH), Leveraged Loan Commitments, and the Tender Option Bond (TOB) municipal book. The corporate-wide one-day management Value-at-Risk (VaR) stands at \$41.3 million as of June 27, 2008.

Management has significantly reduced aged inventory through sales or designating these as held to maturity assets. Trading stress tests results are also showing reduced risk levels, and trading growth plans remain on hold as management reassesses and reorganizes the business.

Treasury and Balance Sheet Management price risk is high and increasing; however, this risk has not been readily transparent. Recent significant losses in BOLI did not coincide with management disclosures of risk to ALCO or regulators. This lack of transparency has led us to question the validity of management disclosures on other Treasury risks. Management is in process of building a formal Treasury Risk Management function.

Overall risk management of price risk remains satisfactory. While we have significant concerns with Treasury Risk Management, CIB houses the majority of price risk and these processes are satisfactory. CIB has a good price risk management function consisting of a satisfactory price risk model, market risk oversight personnel and adequate reporting. However, control systems are now weak. In particular, certain large transactions lacked the appropriate, detailed review to assess, identify and control risk. Failure to ensure accuracy of a single Credit Default Swap (CDS) agreement resulted in nearly a \$500 million loss. Failure to correctly book two trades resulted in a net gain of \$35 million. MIS aggregation of positions has also been an issue during market disruption. Other issues exist with technology and modeling. While overall price verification processes in CIB are satisfactory, staffing, documentation and testing of these positions needs improvement.

#### **Information Technology (IT) Rating – 2**

Overall, the Operations & Technology Group (OTG) along with the various governance committees provide appropriate oversight through its identification, monitoring and controlling of significant IT risks. For the most part, IT management resolves internal audit and regulatory issues in the normal course of business. Major Risk Remediation projects for access control deficiencies, DCPR, and vendor management are generally receiving appropriate attention. However, the stress on earnings will impact current and interim spending, which could have an adverse impact on major projects, and could raise the risk of losing key personnel. To date, the impacts have been project reprioritization and extending project completion dates. The Investment Review process continues to provide governance over project approvals and resource prioritization to ensure efficiency and completion on project goals.

Technology Risk Management and overall operational risk management control efforts continue to develop and season. However, the immaturity of the processes requires us to be more cautious in our reliance on internal findings. Corporate standards and the quality of documentation need improvement. General reporting is adequate, but improved risk assessment aggregation is needed. Operational risk management practices also need improvement to ensure compliance with Basel II AMA. Management is taking appropriate steps to address these issues.

Support and Delivery activities are satisfactory. With the exception of line of business applications, annual disaster recovery and business continuity testing demonstrates the ability to recover systems. The bank is working to improve proximity risk and pandemic escalation

procedures. Logical and physical data center security over critical IT platforms is satisfactory. Management's completion of the ISR3 remediation efforts has improved the overall security posture of the corporation.

### **Trust Rating – 2**

The administration of fiduciary activities at Wachovia remains fundamentally sound. Executive management is experienced and committed to the growth of asset management activities as part of the bank's diversified strategic plan. Management appropriately addresses regulatory findings and is responsive to recommendations from audit and regulatory authorities.

Operational controls are effective and corporate level control functions, including Internal Audit and Corporate Compliance, provide effective oversight for risk identification. Corporate Risk Management processes are satisfactory, relative to the bank's size and risk profile, and continue to be enhanced to respond to the growing complexities of this business. Compliance with applicable laws, regulations, and accepted standards of fiduciary conduct is satisfactory. Fiduciary issues identified in control assessment reports and Internal Audit reports reflect matters that can be addressed in the normal course of business.

Asset management practices are satisfactory. Policies and practices governing asset management are adequate and fiduciary investment decisions are appropriate. Management's use of an open architecture investment platform provides greater transparency to fiduciary clients and is supported by a reasoned due diligence process.

Fiduciary activities at Wachovia are profitable, and when combined with the remaining asset management business lines, contribute significantly to corporate net operating income. Executive management continues to make reasoned decisions to acquire selected trust business lines and focus resources toward areas seen as growth opportunities.

### **Consumer Compliance Rating – 2**

Wachovia reflects a satisfactory level of compliance with consumer protection laws and regulations. Overall compliance risk is "Moderate" and increasing with some aspects reflecting high risk. BSA/AML risk is "High." The BSA/AML compliance program satisfies regulatory requirements, but still needs attention in certain areas. More details are noted in the *Other Supervisory Concerns* section of this Report.

The corporate oversight process includes substantial resources allocated to implement and monitor compliance with the various laws, rulings, regulations, policies and procedures. While the inherent volume of risk in this large and diversified bank is high, the compliance risk management structure helps to minimize risk. Our supervisory efforts will continue to monitor recent changes within the compliance management structure, including the oversight for BSA/AML activities.

The Wachovia 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) a training program for appropriate personnel. The system of internal controls includes policies, procedures and processes that identify high risk products, services and customers with updates designed to account for changes. Senior Vice President Soto has been designated the BSA/AML officer responsible for ongoing oversight of the program, and the Internal Audit BSA/AML function is the primary source for independent testing. An adequate training program exists which includes comprehensive training at the enterprise-wide level, and specific risks are considered when designing training at the individual lines of business.

Our fair lending examination found no evidence of illegal discriminatory practices; fair lending risk management is generally satisfactory. The examination identified the need to improve risk management and assessments of broker-generated loans.

### **Community Reinvestment Act Rating – 1**

Bank performance to help meet community credit needs reflects a rating of “Outstanding”. The evaluation of Wachovia performance is reflected in the CRA Public Disclosures (lead bank and Delaware issued in early 2008 and late 2007). This rating reflects the efforts by management to effectively determine credit, investment, and service needs of the defined assessment areas. Management has also taken meaningful actions to address those needs, especially for low- and moderate-income individuals and geographies, as well as for small businesses. We found that Wachovia has complied with the requirements of the implementing regulation (12 C.F.R. 25) for the public notice and public file.

## RISK ASSESSMENT SUMMARY

RISK PROFILE	QUANTITY OF RISK	QUALITY OF RISK MANAGEMENT	AGGREGATE RISK	DIRECTION
Strategic	----	----	High	<b>Increasing</b>
Reputation	----	----	<b>High</b>	Increasing
Credit	<b>High</b>	Satisfactory	<b>High</b>	Increasing
Interest Rate	Moderate	Satisfactory	Moderate	Increasing
Liquidity	<b>High</b>	<b>Satisfactory</b>	<b>High</b>	Increasing
Price	<b>High</b>	Satisfactory	<b>High</b>	Stable
Foreign Currency Translation	Low	Satisfactory	Low	Stable
Transaction	High	Satisfactory	High	Stable
Compliance	Moderate	Satisfactory	Moderate	Increasing

	QUANTITY OF RISK	QUALITY OF RISK MANAGEMENT	AGGREGATE RISK	DIRECTION
BSA/AML	High	Satisfactory	High	Stable

*\*Bold font indicates a change from the June 30, 2007 Report of Examination.*

	AGGREGATE RISK
Internal Control	Satisfactory
Audit	Satisfactory

### Strategic Risk – High

Strategic risk is “High” and increasing due to the continued impact of the market disruption. Wachovia’s problems are being magnified by questionable strategic decisions, lack of due diligence, and incomplete vetting of the risks associated with strategic decisions. The Board has now acknowledged that the Golden West acquisition was a mistake. Strategic efforts are now focused on generating, protecting and preserving capital. The market disruption has significantly impacted Wachovia’s structured products business and will have a significant continuing profitability impact until markets are re-established or new revenue sources are identified. At this point, Wachovia is strategically pulling back from this business and has recently announced staff reductions in CIB. Wachovia is also exiting the wholesale mortgage origination business, which will result in additional personnel cuts. International expansion activities have slowed and reduced in scale in many cases. On the domestic front, the western branch expansion plans into

California, Nevada, and Arizona, along with the opening of branches in Texas, will continue, but at a slower pace. Major cost containment initiatives, instituted in late second quarter 2008 will likely have an impact on Wachovia's strategic initiatives.

### **Reputation Risk – High**

Wachovia's Reputation Risk is now considered "High" and increasing. Primary driver of the rating is the recently poor earnings performance compounded by market disruption and its impact on Wachovia's earnings, stock price and overall reputation. The market now perceives Wachovia as a troubled institution. Wachovia's reputation continues to be negatively impacted by the acquisition of legacy Golden West in 2006 and the significant decline in the mortgage lending business. Wachovia has been subject to ongoing negative media attention as a result of its poor earnings results; the issuance of the Formal Agreement with fines/restitution charges for the Payment Processing Center, LLC (PPC) relationship; the Department of Justice (DOJ) investigation into *casas de cambio* activities involving alleged money laundering of drug proceeds; the DOJ investigation into municipal bond rigging; regulatory investigations into auction rate securities; the markdown on its Sale-in, Lease-out (SILO) transactions; and the BOLI earnings charge.

### **Credit Risk – High**

Aggregate credit risk is "High," with the quantity of risk rated "High" and the quality of risk management rated satisfactory, although weaknesses exist in the risk management function. The direction of risk remains increasing. The aggregate and quantity ratings represent downgrades from the previous moderate level rating. Underwriting, strategic, external and quantity of credit risk factors are now all considered high. Asset quality metrics continue to worsen and are considered less than satisfactory as they are coming off the pristine levels of recent years. Continued deterioration is most evident in consumer mortgages, residential builders and indirect autos with other portfolios showing milder weakness. While current lagging indicators appear manageable, losses, delinquencies and criticized assets are projected to reach levels that are of concern.

Management is taking action to mitigate this increasing credit risk. They are addressing several self identified weaknesses and increased the depth of risk management portfolio analysis. Policy, personnel and control system factors are satisfactory, although risk management processes remain weak. Management needs better ways to aggregate risk across the corporation. Management also lacked proactive processes to identify risk in the legacy Golden West acquired portfolio. The market disruptions revealed the need for improved processes to measure, monitor, and control risk in the structured products area and the need for a more formalized process to aggregate and control pipeline distribution risks primarily in leveraged lending, Commercial Mortgage-Backed Securities (CMBS) and structured products.

The slumping housing market and broader economic slowdown continue to cause asset quality deterioration. These credit risk indicators have yet to stabilize and support the continued increasing direction of risk.



**Interest Rate Risk (IRR) – Moderate**

Interest Rate Risk remains “Moderate” and increasing, as noted in the Market Sensitivity rating earlier in the Report. Management has used a number of strategies, including active positioning with derivative and cash instruments to change the company’s net exposure. Because of the uncertainty around future rates, management has decided to hold exposures steady and opportunistically replace hedges over time.

Management of IRR exposures remains satisfactory due to experienced staff and their ability to adapt to changing market conditions. Due to earnings volatility, management has recommended to ALCO that short term IRR be measured as a percentage of net interest income (NII) with a policy limit of 3.5% of projected 12 month NII. Historical analysis shows that this is a reasonable limit. Modifications to the BancWare system are still needed to properly model Golden West products. EVE modeling is being implemented under a separate project phase and will be evaluated in the fourth quarter 2008. Management has taken steps to address previous concerns regarding the lack of formal project management.

**Liquidity Risk – High**

Liquidity risk in aggregate is being raised to “High” due to the company’s financial deterioration and investors and the market’s concerns about Wachovia. Wachovia, as compared to other financial institutions, has more expensive term funding and reduced availability. All major credit agencies have downgraded Wachovia's credit rating one notch as expected following the earnings announcement on July 22, 2008. The Net Funding Gap risk has been raised to high, given the significant funding gaps which could occur in a severe funding scenario.

Liquidity management remains satisfactory; management is taking action to build and retain liquid assets. Wachovia recently produced two stress scenarios in order to assess and plan for the impact of a potential credit downgrade to better deal with this environment. The contingency funding plan has been activated to build liquidity in light of negative perceptions and potential customer and investor panic. Wachovia has established a centralized communication response team to deal with inquiries from interested parties, including its retail branch management team and the media. As noted under the Liquidity rating earlier in this Report, given the critical condition of Wachovia’s Liquidity position, the Board needs to ensure that funding continues to be actively monitored, and actions are taken to strengthen liquidity. Formal reporting to the Board is also needed.

In management’s stress scenarios, the moderate scenario reflects sufficient liquidity. Under the severe scenario, Wachovia reflects significant funding gaps. Management has put in place strategies to reduce funding gaps presented in these scenarios.

**Price Risk - Moderate**

Aggregate Price Risk remains “High”, with the quantity of risk “High” and the direction stable. While CIB trading risk is decreasing, Treasury and Balance Sheet Management risk is increasing, primarily due to the increase in BOLI risk. The overall direction of price risk remains stable. We continue to be concerned with the lack of transparency of some Treasury and

Balance Sheet Management risks; however, we note that management is developing a plan to address these issues.

Treasury and Balance Sheet Management price risk is high and increasing. Treasury takes a significant level of risk which has not been readily transparent. In particular, the recent significant losses in BOLI do not coincide with management disclosures of risk to ALCO or regulators. This lack of transparency has led us to question the validity of management disclosures on other Treasury risks. Management is in process of building a formal Treasury Risk Management function.

CIB Trading activities, in aggregate and quantity, reflect a high but decreasing level of risk. The market disruption has led to increased profit and loss (PNL) volatility and limited liquidity, resulting in an increased level of risk. However, marked to market positions continue to decrease. Trading Risk remains centered in ESH, Leveraged Loan Commitments, and the TOB municipal book. The corporate-wide one-day management VaR stands at \$41.3 million as of June 27, 2008. Management has significantly reduced aged inventory through sales or designating these as held to maturity assets. Trading stress tests results are also showing reduced risk levels, and trading growth plans remain on hold as management reassesses and reorganizes the business.

Overall risk management of price risk remains satisfactory. While we have significant concerns with Treasury Risk Management, CIB houses the majority of price risk and these processes are satisfactory.

Treasury and Balance Sheet risk management processes are weak. We noted significant weaknesses in BOLI processes and controls. Processes are weak due to the inadequacy of risk measurement systems to capture risks inherent in the transactions. Additionally, the adequacy of independent measurement and analysis of risk under a variety of scenarios was inadequate. Management information is also misleading, as significant losses were not disclosed in MIS to ALCO or the regulators. Control systems are also weak as risk-monitoring and control functions failed to detect these issues in a timely manner.

CIB Market Risk Management is satisfactory; however, control systems are now considered weak. In particular, certain large transactions lacked the appropriate, detailed review to assess, identify and control risk. MIS aggregation of positions has also been an issue during market disruption. While overall price verification processes in CIB are satisfactory, staffing, documentation and testing of these positions needs improvement. Other issues exist with technology and modeling.

#### **Foreign Currency Translation Risk - Low**

This risk remains very low. Residual risk is limited to the translation of net operating income from foreign operations.

**Transaction Risk – High**

Transaction risk is considered “High” and stable. The quantity of transaction risk is “High” primarily due to growth in the volume, type, and complexity of transactions. Products and services continue to grow as does the bank’s reliance on automation for support and delivery. Operational risk governance continues to expand and improve.

On April 24, 2008, Wachovia entered into a Formal Agreement with the OCC for the purpose of improving internal controls and risk management systems related to the bank’s acceptance of remotely created checks (RCC’s). Treasury Services Risk Management is leading several governance initiatives including development of guidelines for unacceptable uses of RCC’s and account underwriting procedures. Risk management enhancements are also being implemented in order to monitor RCC usage and detect and investigate potential fraud. We will evaluate the sufficiency of these corrective actions via target examination and ongoing monitoring activities.

Corporate Financial Governance continues to track corrective actions related to the risk of unauthorized access to financial systems and control weaknesses surrounding spreadsheets used in the preparation of financial reports. Significant progress is noted in the remediation of these weaknesses. We will continue to monitor management’s efforts to sustain revised control frameworks in each area.

Management completed the majority of the issues related to the Corporate Information Security (CIS) remediation work which has led to improvements in the bank’s information security profile. Internal audit continues to validate the effectiveness of corrective actions and sustainability of controls. Additionally, controls over developer access to distributed systems are being addressed under the Distributed Systems Access Control project.

Management continues to appropriately address the DCPR issue identified several years ago. In the past year, the DCPR project was extended due to the A.G. Edwards Inc. merger integration. Management does not anticipate reaching an “acceptable” level of risk until late 2009. The Phase 1 Pilot has been completed, and Phase II has been initiated. Successful completion of Phase II will enable the bank to achieve acceptable proximity risk reduction. We will continue to closely monitor management’s implementation efforts and execution risks through all project phases.

Governance processes and internal controls for managing domestic vendors have not been effective. However, management continues to make progress toward implementing governance and internal controls for managing domestic vendors. Management is in process of implementing an end-to-end vendor management governance and control process to address these weaknesses. Vendor risk will remain high until the new procedures are fully implemented and the employees trained. This is expected by year-end 2008.

The direction of Transaction Risk remains stable. We will continue to monitor a number of activities that could increase this risk. Offshoring, the A.G. Edwards, Inc. conversion, expanding domestic and international presence, and the impact of budgetary constraints could impact future

transaction risk ratings. Also, we plan to monitor OTG's transformation to its new operating model. The new operating model better aligns with business strategy changes and will enable IT to deliver high quality products, services and support. Ineffective execution in this new model could cause transaction risks to increase.

### **Compliance Risk – Moderate**

The aggregate compliance risk of "Moderate" reflects the strength of risk management systems, processes, and personnel to mitigate inherent risks associated with operations in a company as large and diversified as Wachovia. Overall compliance policies and processes are sound. The level of compliance with consumer protection laws and regulations, including fair lending regulations, is also satisfactory. CRA ratings for the lead bank and the Delaware bank are "Outstanding."

Compliance management has resources available to successfully incorporate the company's ongoing expansion of territory and product offerings. The increased risk from additional products, services, and geographies is mitigated to a great extent by the demonstrated success of Wachovia.

In 2008, the OCC met several times with management regarding efforts to comply with one aspect of Advisory Letter 2003-3 - "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans." Specifically, the bank needs a process for review of written agreements between borrowers and brokers to ensure that the agreements conspicuously disclose the fees to be paid to the broker for services; contain a specific request for such broker services at that fee; and include a signed and dated acknowledgement of receipt by the consumer before the broker commences services. The bank should also retain copies of this documentation. Management has committed that all Wachovia units which utilize brokers for loan production will be in compliance by July 31, 2008. In addition, management has committed that all loans purchased will also comply by that same date. The OCC will test for compliance at a later date, but this should be less of an issue since Wachovia is exiting the wholesale origination business.

### **BSA/AML – High**

Aggregate BSA/AML risk, a component of Compliance Risk, remains "High" and reflects inherent risk associated with the volume and diversity of products and services, operating locations (domestic and foreign), and the broad customer base of Wachovia for varied transactions. The Currency Transaction Report (CTR) back-filing issues remain outstanding as a result of poor past practices in CTR exemption processes; but significant progress has been made to remediate this matter. While the Wachovia BSA/AML compliance program satisfies regulatory requirements overall, additional efforts are needed in some lines of business to ensure the optimum level of consistency in risk assessment and management.

### **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. Recent market disruption events and legal and regulatory issues have highlighted the need for stronger management of risk throughout Wachovia. Clearer roles and responsibilities, consistent

identification and escalation of risk issues, and a robust Treasury Risk Management function are needed. Recent operational/process breakdowns within the Treasury and CIB areas have resulted in significant and unexpected losses.

Risk assessment processes exist in most areas of the bank, although these processes are inconsistent. Management's decentralized approach lends itself to an environment with inconsistent identification, escalation, and management of risk. Risks are being identified, but not consistently prioritized and escalated, when needed. Management is in the process of developing a more consistent methodology for the identification, reporting, and aggregating of operational risks.

Accounting information and communication systems are satisfactory, and financial reporting controls continue to receive scrutiny via the Corporate Financial Governance Office (CFG). While Wachovia's Sarbanes-Oxley program is effective, our recent examination and a recent internal audit of this area have identified the need for improved oversight and monitoring. Policies and procedures are in place to control risk of inaccurate financial reporting.

Audit continues to be effective in identifying control weaknesses throughout the company. Control remediation efforts are adequately tracked with improving trends noted in the timeliness of audit validation of "management closed" control issues.

#### **Internal Audit – Satisfactory**

Wachovia's internal audit (Audit) function remains "Satisfactory." The Audit Committee and new Chief Auditor have elevated Audit's stature within Wachovia. Audit Committee oversight and support is appropriate, and audit management/processes, reporting, and staffing are all satisfactory. Audit issues are appropriately escalated to senior management and the Audit Committee, and management is taking timely and appropriate action to address internal control weaknesses.

Chief Auditor Julian has outlined a new vision and direction for Audit that provides for a more flexible program that reacts to current market conditions and looks more horizontally across the organization to identify risk governance and control weaknesses. Audit leadership is encouraged to continue in these efforts and also to continue towards providing more explicit opinions on Wachovia's overall risk profile and quality of risk management within the lines of business, as well as, on an enterprise-wide basis.

The IT Audit function continues to be an area needing improvement. While progress has been made in the past year to improve overall quality, additional efforts are needed to ensure that a sustainable program is in place to provide effective IT Audit coverage. Audit leadership is addressing this issue.

# APPENDIX

## **Compliance with Formal Agreement**

### **Overall Status**

Management and the Board have made satisfactory progress addressing the requirements and deliverables specified in the Agreement. This includes formation of a Compliance Committee to monitor and coordinate the bank's adherence to the provisions of the Agreement. All required submissions have been received in a timely manner including those related to governance processes, restitution plans, risk management enhancements, and education programs. Because the Agreement was only recently signed, it is too early in the process to assess full compliance.

*The OCC plans to evaluate the sufficiency of the policies, procedures, and plans submitted pursuant to the Agreement during an examination scheduled to commence August 4, 2008.* This will include evaluating the operating effectiveness of control systems underpinning the newly implemented policies. Specifics of the Agreement are outlined below.

### **Article I - No Requirements**

#### **Article II - Compliance Committee and Quarterly Progress Reporting**

*Status: In compliance.*

The Compliance Committee held its first meeting May 22, 2008, and delivered its written report to the Board on May 27, 2008. Committee composition is consistent with the terms of the Agreement, and the Committee charter is in place addressing meeting frequencies and required reporting timeframes. The Committee's first progress report was provided to the OCC on June 6, 2008.

*Future Actions:* The next Compliance Committee progress report is due by October 10, 2008.

#### **Article III - Consumer Restitution**

*Status: In Progress.*

The bank established and funded a segregated deposit account on May 9, 2008, setting aside \$125 million for consumer restitution. The bank contracted with Rust Consulting Inc. to develop and execute a Restitution Plan (Plan) consistent with the terms of the Agreement. The bank's Plan was submitted to the OCC on June 6, 2008.

*Future Actions:* The OCC will evaluate the Plan during an examination scheduled to commence August 4, 2008. The Plan calls for written status reports to be provided to OCC on August 15, 2008; September 29, 2008; January 27, 2009; April 27, 2009; and October 26, 2009.

*Other Matters:* On June 5, 2008, the United States Attorney for Eastern District of Pennsylvania submitted to United States Magistrate Timothy Rice proposed revisions to the restitution plan originally specified in the Permanent Injunction against PPC dated February 12, 2007. The proposed revisions entail a direct reimbursement methodology thereby eliminating the claims process specified in the original ruling. The Court has not yet ruled on this proposal.

**Article IV - Consumer Education and Reserve**

*Status: In progress.*

The bank established and funded a segregated deposit account on May 9, 2008, setting aside \$8.9 million for consumer education. The bank submitted a Consumer Education Plan to the OCC on June 6, 2008.

*Future Actions:* The OCC will evaluate the Consumer Education Plan during an examination scheduled to commence August 4, 2008.

**Article V - Policies and Procedures for Acceptance of Remotely Created Checks (RCC)**

*Status: In progress.*

On June 6, 2008, the bank submitted written policies, procedures or standards applicable to its banking relationships with customers who regularly deposit RCC. These documents include policies entitled “High Risk Reputation Industries” and “Remotely Created Checks”, related procedures, and training materials.

*Future Actions:* The OCC will evaluate the submitted policies for required content and operating effectiveness during an examination scheduled to commence August 4, 2008.

**Article VI - Due Diligence and Underwriting**

*Status: In progress.*

On June 6, 2008, the bank submitted due diligence and underwriting standards for covered RCC depositors.

*Future Actions:* The OCC will evaluate the submitted standards for required content and operating effectiveness during an examination scheduled to commence August 4, 2008.

**Article VII - Risk Management**

*Status: In progress.*

On June 6, 2008, the bank submitted copies of procedures currently in place for monitoring RCC depositors and return rates. On June 20, 2008, the bank submitted a Case Management Plan providing a high level overview of steps being taken to improve case management system functionality. Authorization for Treasury Services Risk Management to unilaterally close accounts was implemented in 2007.

*Future Actions:* The OCC will evaluate the submitted policies, project plans, and revised risk management procedures for operating effectiveness during an examination scheduled to commence August 4, 2008.

**Article VIII - Consumer Protection**

*Status: In progress.*

The bank will review the accounts of its RCC depositors for compliance with the policies submitted pursuant to this Agreement after supervisory non-objection to the revised policies is received. The bank submitted a certification dated June 4, 2008, indicating it has discovered no



Covered RCC Depositor relationships with tiered pricing arrangements, non-standard agreements designed to limit the bank's liability for any damages, or arising from the customer's activities at the bank related to consumer transactions. The bank submitted a certification dated June 17, 2008, indicating annual compliance training for employees has been enhanced. Copies of revised training material were provided on June 20, 2008.

*Future Actions:* The OCC will evaluate the materials submitted pursuant to this Article during an examination scheduled to commence August 4, 2008.

#### **Article IX - Relationships with Other Covered RCC Depositors**

On May 5, 2008, the bank submitted a certification relating to a diligent search for other telemarketers or payment processors for telemarketers that used RCCs. A list of these depository relationships was provided at that time. A revised list was submitted June 19, 2008.

*Future Actions:* None anticipated.

#### **Article X - No Requirements**

#### **Article XI - No Requirements**

**Signatures of Directors**

We, the undersigned directors of Wachovia Corporation, Charlotte, NC have personally reviewed the contents of this Report of Examination for Wachovia Bank, National Association, dated June 30, 2008.

<b>NAMES:</b>	<b>SIGNATURES:</b>	<b>DATES:</b>
Lanty L. Smith (Chairman)	_____	_____
John D. Baker II	_____	_____
Peter C. Browning	_____	_____
John T. Casteen, III	_____	_____
Jerry Gitt	_____	_____
William H. Goodwin, Jr.	_____	_____
Maryellen C. Herringer	_____	_____
Robert A. Ingram	_____	_____
Donald M. James	_____	_____
Mackey J. McDonald	_____	_____
Joseph Neubauer	_____	_____
Timothy D. Proctor	_____	_____
Earnest S. Rady	_____	_____
Van L. Richey	_____	_____
Ruth G. Shaw	_____	_____
Robert K. Steel	_____	_____
Donna Davis Young	_____	_____

NOTE: This form should remain attached to the Report of Examination and be retained in the institution's file for review during subsequent examinations. The signature of committee members will suffice only if the committee includes outside directors and a resolution has been passed by the full Board delegating the review to such committee.