WELLS FARGO & COMPANY/MN
Form 10-Q
August 03, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

Commission file number 001-2979

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

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

420 Montgomery Street, San Francisco, California 94163
(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: 1-866-249-3302

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

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

	Shares Outstanding July 25, 2018
Common stock, $1-2/3 par value	4,816,137,157

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CROSS-REFERENCE INDEX

PART I - FINANCIAL INFORMATION

FINANCIAL REVIEW
Summary Financial Data

($ in millions, except per share amounts)	Quarter ended Jun 30, 2018	Mar 31, 2018	Jun 30, 2017	% Change Jun 30, 2018 from Mar 31, 2018	Jun 30, 2017	Six months ended Jun 30, 2018	Jun 30, 2017	% Change
For the Period								
Wells Fargo net income	$5,186	5,136	5,856	1 %	(11)	$10,322	11,490	(10)%
Wells Fargo net income applicable to common stock	4,792	4,733	5,450	1	(12)	9,525	10,683	(11)
Diluted earnings per common share	0.98	0.96	1.08	2	(9)	1.94	2.11	(8)
Profitability ratios (annualized):								
Wells Fargo net income to average assets (ROA)	1.10 %	1.09	1.22	1	(10)	1.10 %	1.20	(8)
Wells Fargo net income applicable to common stock to average Wells Fargo common stockholders' equity (ROE)	10.60	10.58	12.06	—	(12)	10.59	12.01	(12)
Return on average tangible common equity (ROTCE) (1)	12.62	12.62	14.41	—	(12)	12.62	14.38	(12)
Efficiency ratio (2)	64.9	68.6	60.9	(5)	7	66.7	61.4	9
Total revenue	$21,553	21,934	22,235	(2)	(3)	$43,487	44,490	(2)
Pre-tax pre-provision profit (PTPP) (3)	7,571	6,892	8,694	10	(13)	14,463	17,157	(16)
Dividends declared per common share	0.39	0.39	0.38	—	3	0.780	0.760	3
Average common shares outstanding	4,865.8	4,885.7	4,989.9	—	(2)	4,875.7	4,999.2	(2)
Diluted average common shares outstanding	4,899.8	4,930.7	5,037.7	(1)	(3)	4,916.1	5,054.8	(3)
Average loans	$944,079	951,024	956,879	(1)	(1)	$947,532	960,243	(1)
Average assets	1,884,884	1,915,896	1,927,021	(2)	(2)	1,900,304	1,929,020	(1)
Average total deposits	1,271,339	1,297,178	1,301,195	(2)	(2)	1,284,187	1,300,198	(1)
Average consumer and small business banking deposits (4)	754,047	755,483	760,149	—	(1)	754,898	759,455	(1)
Net interest margin	2.93 %	2.84	2.90	3	1	2.89 %	2.89	—
At Period End								
Debt securities (5)	$475,495	472,968	462,890	1	3	$475,495	462,890	3
Loans	944,265	947,308	957,423	—	(1)	944,265	957,423	(1)
	10,193	10,373	11,073	(2)	(8)	10,193	11,073	(8)

Allowance for loan losses								
Goodwill	26,429	26,445	26,573	—	(1)	26,429	26,573	(1)
Equity securities (5)	57,505	58,935	55,742	(2)	3	57,505	55,742	3
Assets	1,879,700	1,915,388	1,930,792	(2)	(3)	1,879,700	1,930,792	(3)
Deposits	1,268,864	1,303,689	1,305,830	(3)	(3)	1,268,864	1,305,830	(3)
Common stockholders' equity	181,386	181,150	181,233	—	—	181,386	181,233	—
Wells Fargo stockholders' equity	205,188	204,952	205,034	—	—	205,188	205,034	—
Total equity	206,069	205,910	205,949	—	—	206,069	205,949	—
Tangible common equity (1)	152,580	151,878	151,868	—	—	152,580	151,868	—
Capital ratios (6):								
Total equity to assets	10.96 %	10.75	10.67	2	3	10.96 %	10.67	3
Risk-based capital:								
Common Equity Tier 1	11.98	11.92	11.87	1	1	11.98	11.87	1
Tier 1 capital	13.83	13.76	13.68	1	1	13.83	13.68	1
Total capital	16.98	16.92	16.91	—	—	16.98	16.91	—
Tier 1 leverage	9.51	9.32	9.28	2	2	9.51	9.28	2
Common shares outstanding	4,849.1	4,873.9	4,966.8	(1)	(2)	4,849.1	4,966.8	(2)
Book value per common share (7)	$37.41	37.17	36.49	1	3	$37.41	36.49	3
Tangible book value per common share (1)(7)	31.47	31.16	30.58	1	3	31.47	30.58	3
Common stock price:								
High	57.12	66.31	56.60	(14)	1	66.31	59.99	11
Low	50.26	50.70	50.84	(1)	(1)	50.26	50.84	(1)
Period end	55.44	52.41	55.41	6	—	55.44	55.41	—
Team members (active, full-time equivalent)	264,500	265,700	270,600	—	(2)	264,500	270,600	(2)

(1) Tangible common equity is a non-GAAP financial measure and represents total equity less preferred equity, noncontrolling interests, and goodwill and certain identifiable intangible assets (including goodwill and intangible assets associated with certain of our nonmarketable equity securities, but excluding mortgage servicing rights), net of applicable deferred taxes. The methodology of determining tangible common equity may differ among companies. Management believes that return on average tangible common equity and tangible book value per common share, which utilize tangible common equity, are useful financial measures because they enable investors and others to assess the Company's use of equity. For additional information, including a corresponding reconciliation to GAAP financial measures, see the “Capital Management – Tangible Common Equity” section in this Report.

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

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

(4) Consumer and small business banking deposits are total deposits excluding mortgage escrow and wholesale deposits.

(5) Financial information for the prior periods of 2017 has been revised to reflect the impact of the adoption in first quarter 2018 of Accounting Standards Update (ASU) 2016-01 – Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which amends the presentation and accounting for certain financial instruments, including equity securities. See Note 1 (Summary of Significant

Accounting Policies) to Financial Statements in this Report for more information.

(6) The risk-based capital ratios were calculated under the lower of Standardized or Advanced Approach determined pursuant to Basel III. Beginning January 1, 2018, the requirements for calculating common equity tier 1 and tier 1 capital, along with risk-weighted assets, became fully phased-in; however, the requirements for calculating tier 2 and total capital are still in accordance with Transition Requirements. See the “Capital Management” section and Note 22 (Regulatory and Agency Capital Requirements) to Financial Statements in this Report for additional information.

(7) Book value per common share is common stockholders' equity divided by common shares outstanding. Tangible book value per common share is tangible common equity divided by common shares outstanding.

Overview (continued)

This Quarterly Report, including the Financial Review and the Financial Statements and related Notes, contains forward-looking statements, which may include forecasts of our financial results and condition, expectations for our operations and business, and our assumptions for those forecasts and expectations. Do not unduly rely on forward-looking statements. Actual results may differ materially from our forward-looking statements due to several factors. Factors that could cause our actual results to differ materially from our forward-looking statements are described in this Report, including in the "Forward-Looking Statements" section, and the "Risk Factors" and "Regulation and Supervision" sections of our Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Form 10-K).

When we refer to "Wells Fargo," "the Company," "we," "our," or "us" in this Report, we mean Wells Fargo & Company and Subsidiaries (consolidated). When we refer to the "Parent," we mean Wells Fargo & Company. See the Glossary of Acronyms for definitions of terms used throughout this Report.

Financial Review[1]

Overview

Wells Fargo & Company is a diversified, community-based financial services company with $1.88 trillion in assets. Founded in 1852 and headquartered in San Francisco, we provide banking, investment, and mortgage products and services, as well as consumer and commercial finance, through 8,050 locations, 13,000 ATMs, digital (online, mobile and social), and contact centers (phone, email and correspondence), and we have offices in 38 countries and territories to support customers who conduct business in the global economy. With approximately 265,000 active, full-time equivalent team members, we serve one in three households in the United States and ranked No. 26 on Fortune's 2018 rankings of America's largest corporations. We ranked fourth in assets and third in the market value of our common stock among all U.S. banks at June 30, 2018.

We use our Vision, Values and Goals to guide us toward growth and success. Our vision is to satisfy our customers' financial needs and help them succeed financially. We aspire to create deep and enduring relationships with our customers by providing them with an exceptional experience and by understanding their needs and delivering the most relevant products, services, advice, and guidance.

We have five primary values, which are based on our vision and guide the actions we take. First, we place customers at the center of everything we do. We want to exceed customer expectations and build relationships that last a lifetime. Second, we value and support our people as a competitive advantage and strive to attract, develop, motivate, and retain the best team members. Third, we strive for the highest ethical standards of integrity, transparency, and principled performance. Fourth, we value and promote diversity and inclusion in all aspects of business and at all levels. Fifth, we look to each of our team members to be a leader in establishing, sharing, and communicating our vision for our customers, communities, team members, and shareholders. In addition to our five primary values, one of our key day-to-day priorities is to make risk management a competitive advantage by working hard to ensure that appropriate controls are in place to reduce risks to our customers, maintain and increase our competitive market position, and protect Wells Fargo's long-term safety, soundness, and reputation.

[1] Financial information for the prior periods of 2017 has been revised to reflect our adoption in first quarter 2018 of Accounting Standards Update (ASU) 2016-01 Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. See Note 1 (Summary of Significant Accounting Policies) to Financial Statements in this Report for more information.

In keeping with our primary values and risk management priorities, we have six long-term goals for the Company, which entail becoming the financial services leader in the following areas:

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- Customer service and advice – provide exceptional service and guidance to our customers to help them succeed financially.
- Team member engagement – be a company where people feel included, valued, and supported; everyone is respected; and we work as a team.
- Innovation – create lasting value for our customers and increased efficiency for our operations through innovative thinking, industry-leading technology, and a willingness to test and learn.
- Risk management – set the global standard in managing all forms of risk.
- Corporate citizenship – make a positive contribution to communities through philanthropy, advancing diversity and inclusion, creating economic opportunity, and promoting environmental sustainability.
- Shareholder value – deliver long-term value for shareholders.

Federal Reserve Board Consent Order Regarding Governance Oversight and Compliance and Operational Risk Management

On February 2, 2018, the Company entered into a consent order with the Board of Governors of the Federal Reserve System (FRB). As required by the consent order, the Board submitted to the FRB a plan to further enhance the Board's governance and oversight of the Company, and the Company submitted to the FRB a plan to further improve the Company's compliance and operational risk management program. The consent order also requires the Company, following the FRB's acceptance and approval of the plans and the Company's adoption and implementation of the plans, to complete third-party reviews of the enhancements and improvements provided for in the plans. Until these third-party reviews are complete and the plans are approved and implemented to the satisfaction of the FRB, the Company's total consolidated assets will be limited to the level as of December 31, 2017. Compliance with this asset cap will be measured on a two-quarter daily average basis to allow for management of temporary fluctuations. The Company has had constructive dialogue with, and has received detailed feedback from, the FRB regarding the plans. In order to have enough time to incorporate this feedback into the plans in a thoughtful manner and to complete the required third-party reviews, which were initially due September 30, 2018, the Company is planning to operate under the asset cap through the first part of 2019. A second third-party review must also be conducted to assess the efficacy and sustainability of the improvements. During second quarter 2018, our average assets were below our level of total assets as of December 31, 2017.

Consent Orders with the Consumer Financial Protection Bureau (CFPB) and Office of the Comptroller of the Currency (OCC) Regarding Compliance Risk Management Program, Automobile Collateral Protection Insurance Policies, and Mortgage Interest Rate Lock Extensions

On April 20, 2018 we entered into consent orders with the CFPB and OCC to pay an aggregate of $1 billion in civil money penalties to resolve matters regarding our compliance risk management program and past practices involving certain automobile collateral protection insurance policies and certain mortgage interest rate lock extensions. As required by the consent orders, the Company submitted to the CFPB and OCC an enterprise-wide compliance risk management plan and a plan to enhance the Company's internal audit program with respect to federal consumer financial law and the terms of the consent orders. In addition, as required by the consent orders, the Company submitted for non-objection plans to remediate customers affected by the automobile collateral protection insurance and mortgage interest rate lock matters. The consent orders also require the Company to submit for non-objection, within 120 days of the date of the consent orders, a plan to develop and implement a remediation program that is applicable to remediation activities conducted by the Company.

Retail Sales Practices Matters

As we have previously reported, in September 2016 we announced settlements with the CFPB, the OCC, and the Office of the Los Angeles City Attorney, and entered into consent orders with the CFPB and the OCC, in connection with allegations that some of our retail customers received products and services they did not request. As a result, it remains our top priority to rebuild trust through a comprehensive action plan that includes making things right for our customers, team members, and other stakeholders, and building a better Company for the future.

Our priority of rebuilding trust has included numerous actions focused on identifying potential financial harm and customer remediation. The Board and management are conducting company-wide reviews of sales practices issues. These reviews are ongoing. In August 2017, a third-party consulting firm completed an expanded data-driven review of retail banking accounts opened from January 2009 to September 2016 to identify financial harm stemming from potentially unauthorized accounts. We have provided customer remediation based on the expanded account analysis. For additional information regarding sales practices matters, including related legal matters, see the “Risk Factors” section in our 2017 Form 10-K and Note 13 (Legal Actions) to Financial Statements in this Report.

Additional Efforts to Rebuild Trust

Our priority of rebuilding trust has also included an effort to identify other areas or instances where customers may have experienced financial harm. We are working with our regulatory agencies in this effort. As part of this effort, we are focused on the following key areas:

- Automobile Lending Business The Company is reviewing practices concerning the origination, servicing, and/or collection of consumer automobile loans, including matters related to certain insurance products. For example:

In July 2017, the Company announced a plan to remediate customers who may have been financially harmed due to issues related to automobile collateral protection insurance (CPI) policies purchased through a third-party vendor on their behalf. The practice of

placing CPI had been previously discontinued by the Company. Commencing in August 2017, the Company began sending refund checks and/or letters to affected customers through which they may claim or otherwise receive remediation compensation for policies placed between October 15, 2005, and September 30, 2016. The Company currently estimates that it will provide approximately $212 million in cash remediation under the plan. The amount of remediation may be affected by the requirements of the consent orders entered into with the CFPB and OCC as described above.

The Company has identified certain issues related to the unused portion of guaranteed automobile protection waiver or insurance agreements between the dealer and, by assignment, the lender, which will result in refunds to customers in certain states.

- Mortgage Interest Rate Lock Extensions In October 2017, the Company announced plans to reach out to all home lending customers who paid fees for mortgage rate lock extensions requested from September 16, 2013, through February 28, 2017, and to provide refunds, with interest, to customers who believe they should not have paid those fees. The plan to issue refunds follows an internal review that determined a rate lock extension policy implemented in September 2013 was, at times, not consistently applied, resulting in some borrowers being charged fees in cases where the Company was primarily responsible for the delays that made the extensions necessary. Effective March 1, 2017, the Company changed how it manages the mortgage rate lock extension process by establishing a centralized review team that reviews all rate lock extension requests for consistent application of the policy. Although the Company believes a substantial number of the rate lock extension fees during the period in question were appropriately charged under its policy, due to our customer-oriented remediation approach, we have issued, as of July 31, 2018, over $100 million in refunds and interest to substantially all of our customers who paid rate lock extension fees during the period in question.

- Add-on Products The Company is reviewing practices related to certain consumer “add-on” products, including identity theft and debt protection products that were subject to an OCC consent order entered into in June 2015, as well as home and automobile warranty products, and memberships in discount programs. The products were sold to customers through a number of distribution channels and, in some cases, were acquired by the Company in connection with the purchase of loans. Sales of certain of these products have been discontinued over the past few years primarily due to decisions made in the normal course of business, and by mid-2017, the Company had ceased selling any of them to consumers. The review of the Company's historical practices with respect to these products is ongoing, focusing on, among other topics, sales practices, adequacy of disclosures, customer servicing, and volume and type of customer complaints. We are providing remediation where we identify affected customers, and may also provide refunds to customers who purchased certain products.
- Consumer Deposit Account Freezing/Closing The Company is reviewing procedures regarding the freezing (and, in many cases, closing) of consumer deposit accounts after the Company detected suspected fraudulent activity (by third-parties or account holders) that affected those accounts.

Overview (continued)

- Review of Certain Activities Within Wealth and Investment Management A review of certain activities within Wealth and Investment Management (WIM) being conducted by the Board, in response to inquiries from federal government agencies, is assessing whether there have been inappropriate referrals or recommendations, including with respect to rollovers for 401(k) plan participants, certain alternative investments, or referrals of brokerage customers to the Company's investment and fiduciary services business. The review is ongoing.
- Fiduciary and Custody Account Fee Calculations The Company is reviewing fee calculations within certain fiduciary and custody accounts in its investment and fiduciary services business, which is part of the wealth management business within WIM. The Company has determined that there have been instances of incorrect fees being applied to certain assets and accounts, resulting in both overcharges and undercharges to customers. These issues include the incorrect set-up and maintenance in the system of record of the values associated with certain assets. Systems, operations, and account-level reviews are underway to determine the extent of any assets and accounts affected, and root cause analyses are being performed with the assistance of third parties. These reviews are ongoing and, as a result of its reviews to date, the Company has suspended the charging of fees on some assets and accounts, has notified the affected customers, and is continuing its analysis of those assets and accounts. The Company has accrued $120 million through second quarter 2018 to refund customers who may have been overcharged during the past seven years. The third-party review of customer accounts is ongoing to determine the extent of any additional necessary remediation, including with respect to additional accounts not yet reviewed, which may lead to additional accruals. As these reviews continue, the Company will consider suspending fees on additional assets and accounts, while continuing the process of analyzing those assets and accounts.
- Foreign Exchange Business The Company has substantially completed an assessment, with the assistance of a third party, of its policies, practices, and procedures in its foreign exchange (FX) business. The business is in the process of revising and implementing new policies, practices, and procedures, including those related to pricing. The Company has accrued $171 million through second quarter 2018 for customer remediation and rebate costs. This accrual includes $31 million to remediate customers that may have received pricing inconsistent with commitments made to those customers. The Company's review of affected customers is ongoing to determine the extent of any additional remediation. In addition, this accrual includes $140 million to rebate customers over a seven-year period where historic pricing, while consistent with contracts entered into with those customers, does not conform to recently implemented standards and pricing.
- Mortgage Loan Modifications An internal review of the Company's use of a mortgage loan modification underwriting tool identified a calculation error that affected certain accounts that were in the foreclosure process between April 13, 2010, and October 20, 2015, when the error was corrected. This error in the modification tool caused an automated miscalculation of attorneys' fees that were included for purposes of determining whether a customer qualified for a mortgage loan modification pursuant to the requirements of government-sponsored enterprises (such as

Fannie Mae and Freddie Mac) and the U.S. Department of Treasury's Home Affordable Modification Program (HAMP). Customers were not actually charged the incorrect attorneys' fees. As a result of this error, approximately 625 customers were incorrectly denied a loan modification or were not offered a modification in cases where they would have otherwise qualified. In approximately 400 of these instances, after the loan modification was denied or the customer was deemed ineligible to be offered a loan modification, a foreclosure was completed. The Company has substantially completed its internal review, subject to final validation, of mortgages where an attorney fee-related error could have occurred. In second quarter 2018, the Company accrued $8 million to remediate customers whose modification decisions may have been affected by the calculation error.

To the extent issues are identified, we will continue to assess any customer harm and provide remediation as appropriate. This effort to identify other instances in which customers may have experienced harm is ongoing, and it is possible that we may identify other areas of potential concern. For more information, including related legal and regulatory risk, see the "Risk Factors" section in our 2017 Form 10-K and Note 13 (Legal Actions) to Financial Statements in this Report.

Financial Performance

Wells Fargo net income was $5.2 billion in second quarter 2018 with diluted earnings per common share (EPS) of $0.98, compared with $5.9 billion and $1.08, respectively, a year ago. Second quarter 2018 results included $481 million of net discrete income tax expense mostly related to state income taxes driven by the recent U.S. Supreme Court decision in South Dakota v. Wayfair. Also in second quarter 2018:

- revenue was $21.6 billion, down $682 million compared with a year ago, with net interest income up 1% and noninterest income down 8% from a year ago;
- average loans were $944.1 billion, down $12.8 billion, or 1%, from a year ago;
- average deposits were $1.3 trillion, down $29.9 billion, or 2%, from a year ago;
- return on assets (ROA) of 1.10% and return on equity (ROE) of 10.60%, were down from 1.22% and 12.06%, respectively, a year ago;
- our credit results improved with a net charge-off rate of 0.26% (annualized) of average loans in second quarter 2018, compared with 0.27% a year ago;
- nonaccrual loans of $7.5 billion were down $1.6 billion, or 17%, from a year ago; and
- we returned $4.0 billion to shareholders through common stock dividends and net share repurchases, which was the 12th consecutive quarter of returning more than $3 billion.

Balance Sheet and Liquidity

Despite the asset cap placed on us from the consent order with the FRB, our balance sheet remained strong during second quarter 2018 with strong credit quality and solid levels of liquidity and capital. Our total assets were $1.88 trillion at June 30, 2018. Cash and other short-term investments decreased $52.3 billion from December 31, 2017, reflecting lower deposit balances. Debt securities were $475.5 billion at June 30, 2018, an increase of $2.1 billion from December 31, 2017, driven by an increase in debt securities held for trading partially offset by runoff and sales in the available for sale portfolio. Loans were down $12.5 billion, or 1%, from December 31, 2017, largely due to a decline in automobile and junior lien mortgage loans.

Average deposits in second quarter 2018 were $1.27 trillion, down $29.9 billion from second quarter 2017. The decline was driven by a decrease in commercial deposits, primarily from financial institutions, which includes actions the Company has taken in response to the asset cap, partially offset by higher interest-bearing checking deposits. Our average deposit cost in second quarter 2018 was 40 basis points, up 19 basis points from a year ago, primarily driven by an increase in commercial and Wealth and Investment Management deposit rates.

Credit Quality

Solid overall credit results continued in second quarter 2018 as losses remained low and we continued to originate high quality loans, reflecting our long-term risk focus. Net charge-offs were $602 million, or 0.26% (annualized) of average loans, in second quarter 2018, compared with $655 million a year ago (0.27%). The decrease in net charge-offs in second quarter 2018, compared with a year ago, was driven by lower losses in the commercial and industrial loan and other revolving credit and installment portfolios.

Our commercial portfolio net charge-offs were $67 million, or 5 basis points of average commercial loans, in second quarter 2018, compared with net charge-offs of $75 million, or 6 basis points, a year ago. Net consumer credit losses decreased to 49 basis points (annualized) of average consumer loans in second quarter 2018 from 51 basis points (annualized) in second quarter 2017. Approximately 81% of the consumer first mortgage loan portfolio outstanding at June 30, 2018, was originated after 2008, when more stringent underwriting standards were implemented.

The allowance for credit losses as of June 30, 2018, decreased $1.0 billion compared with a year ago and decreased $850 million from December 31, 2017. We had a $150 million release in the allowance for credit losses in second quarter 2018, compared with a $100 million release a year ago. The allowance coverage for total loans was 1.18% at June 30, 2018, compared with 1.27% a year ago and 1.25% at December 31, 2017. The allowance covered 4.6 times annualized second quarter net charge-offs, compared with 4.6 times a year ago. Future allowance levels will be based on a variety of factors, including loan growth, portfolio performance and general economic conditions. Our provision for loan losses was $452 million in second quarter 2018, down from $555 million a year ago, primarily reflecting an improvement in our outlook for 2017 hurricane-related losses, as well as continued improvement in residential real estate and lower loan balances.

Nonperforming assets decreased $305 million, or 4%, from March 31, 2018, the ninth consecutive quarter of decreases, with improvement in the real estate 1-4 family first mortgage portfolio and lower foreclosed assets. Nonperforming assets were 0.85% of total loans, the lowest level since the merger with Wachovia in 2008. Nonaccrual loans decreased $233 million from the prior quarter predominantly due to a decrease in real estate 1-4 family first mortgage nonaccruals. In addition, foreclosed assets were down $72 million from the prior quarter.

Capital

Our financial performance in second quarter 2018 allowed us to maintain a solid capital position, with total equity of $206.1 billion at June 30, 2018, compared with $208.1 billion at December 31, 2017. We returned $4.0 billion to shareholders in second quarter 2018 through common stock dividends and net share repurchases, an increase of 17% from a year ago. Our net payout ratio (which is the ratio of (i) common stock dividends and share repurchases less issuances and stock compensation-related items, divided by (ii) net income applicable to common stock) was 84%. We continued to reduce our common shares outstanding through the repurchase of 35.8 million common shares in the quarter. We entered into a $1 billion forward repurchase contract with an unrelated third party in April 2018, which settled in July 2018 for 18.8 million common shares. We also entered into a $1 billion forward repurchase contract with an unrelated third party in July 2018 that is expected to settle in fourth quarter 2018 for approximately 18 million common shares. We expect to reduce our common shares outstanding through share repurchases throughout the remainder of 2018.

We believe an important measure of our capital strength is the Common Equity Tier 1 (CET1) ratio under Basel III, fully phased-in, which was 11.98% at June 30, 2018, flat compared with December 31, 2017, but well above our internal target of 10%. Likewise, our other regulatory capital ratios remained strong. We also received a non-objection to our 2018 Capital Plan submission from the FRB. See the “Capital Management” section in this Report for more information regarding our capital, including the calculation of our regulatory capital amounts.

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Earnings Performance

Wells Fargo net income for second quarter 2018 was $5.2 billion ($0.98 diluted earnings per common share), compared with $5.9 billion ($1.08 diluted per share) for second quarter 2017. Net income in second quarter 2018 included net discrete income tax expense of $481 million ($0.10 diluted per share) mostly related to state income taxes driven by the recent U.S. Supreme Court decision in South Dakota v. Wayfair. Second quarter 2018 results also benefited from the lower U.S. federal statutory income tax rate. Net income for the first half of 2018 was $10.3 billion, compared with $11.5 billion for the same period a year ago. The decrease in net income in the first half of 2018, compared with the same period a year ago, resulted from a $16 million decrease in net interest income, a $987 million decrease in noninterest income, and a $1.7 billion increase in noninterest expense, partially offset by a $517 million decrease in our provision for credit losses and a $1.2 billion decline in income tax expense reflecting the lower U.S. federal statutory income tax rate in 2018. In the first half of 2018, net interest income represented 57% of revenue, compared with 56% for the same period a year ago. Noninterest income was $18.7 billion in the first half of 2018, representing 43% of revenue, compared with $19.7 billion (44%) in the first half of 2017.

Revenue, the sum of net interest income and noninterest income, was $21.6 billion in second quarter 2018, compared with $22.2 billion in the same period a year ago. The decrease in revenue in second quarter 2018, compared with the same period a year ago, was due to a decline in noninterest income, partially offset by an increase in net interest income. Revenue for the first half of 2018 was $43.5 billion, compared with $44.5 billion for the first half of 2017. The decline in revenue in the first half of 2018, compared with the same period a year ago, was substantially due to a decline in noninterest income.

Net Interest Income

Net interest income is the interest earned on debt securities, loans (including yield-related loan fees) and other interest-earning assets minus the interest paid on deposits, short-term borrowings and long-term debt. The net interest margin is the average yield on earning assets minus the average interest rate paid for deposits and our other sources of funding. Net interest income and the net interest margin are presented on a taxable-equivalent basis in Table 1 to reflect income from taxable and tax-exempt loans and debt and equity securities based on a 21% and 35% federal statutory tax rate for the periods ended June 30, 2018 and 2017, respectively.

Net interest income and the net interest margin in any one period can be significantly affected by a variety of factors including the mix and overall size of our earning assets portfolio and the cost of funding those assets. In addition, some variable sources of interest income, such as resolutions from purchased credit-impaired (PCI) loans, loan fees and collection of interest on nonaccrual loans, can vary from period to period.

Net interest income on a taxable-equivalent basis was $12.7 billion and $25.1 billion in the second quarter and first half of 2018, respectively, compared with $12.8 billion and $25.4 billion for the same periods a year ago. The decrease in net interest income in the second quarter and first half of 2018, compared with the same periods a year ago, was driven by lower loan swap income due to unwinding the receive-fixed loan swap portfolio, lower tax-equivalent net interest income from updated tax-equivalent factors reflecting new tax law, lower loan balances, unfavorable hedge ineffectiveness accounting, and higher premium amortization, partially offset by the net repricing benefit of higher interest rates, lower long-term debt balances, growth in interest income from debt and equity securities, and higher variable income. The net interest margin was 2.93% in second quarter 2018, up from 2.90% in the same period a year ago. The increase was driven by the net repricing benefit of higher interest rates, lower long-term debt balances, and higher variable income, partially offset by lower loan swap income due to unwinding the receive-fixed loan swap portfolio, lower tax-equivalent net interest income from updated tax-equivalent factors reflecting new tax law, unfavorable hedge ineffectiveness accounting, and higher premium amortization. The net interest margin was 2.89% in both the first half of 2018 and 2017 as the net repricing benefit of higher interest rates, lower long-term debt balances, and higher variable income

was offset by lower loan swap income due to unwinding the receive-fixed loan swap portfolio, lower tax-equivalent net interest income from updated tax-equivalent factors reflecting new tax law, unfavorable hedge ineffectiveness accounting, and higher premium amortization.
Average earning assets decreased $37.5 billion and $26.7 billion in the second quarter and first half of 2018, respectively, compared with the same periods a year ago. Also, compared with the same periods a year ago:

- average loans decreased $12.8 billion and $12.7 billion in the second quarter and first half of 2018, respectively;
- average interest-earning deposits decreased $49.7 billion and $43.0 billion in the second quarter and first half of 2018, respectively;
- average federal funds sold and securities purchased under resale agreements increased $2.9 billion and $2.9 billion in the second quarter and first half of 2018, respectively;
- average debt securities increased $19.2 billion and $19.3 billion in the second quarter and first half of 2018, respectively;
- average equity securities increased $726 million and $3.3 billion in the second quarter and first half of 2018, respectively; and
- other earning assets increased $1.1 billion and $3.6 billion in the second quarter and first half of 2018, respectively.

Deposits are an important low-cost source of funding and affect both net interest income and the net interest margin. Deposits include noninterest-bearing deposits, interest-bearing checking, market rate and other savings, savings certificates, other time deposits, and deposits in foreign offices. Average deposits were $1.27 trillion and $1.28 trillion in the second quarter and first half of 2018, respectively, compared with $1.30 trillion in both the same periods a year ago, and represented 135% of average loans in second quarter 2018 and 136% in the first half of 2018, compared with 136% in second quarter 2017 and 135% in the first half of 2017. Average deposits were 73% of average earning assets in both the second quarter and first half of 2018, flat compared with the same periods a year ago. The average deposit cost for second quarter 2018 was 40 basis points, up 6 basis points from the prior quarter and 19 basis points from a year ago, primarily driven by an increase in commercial and Wealth and Investment Management deposit rates.

Table 1: Average Balances, Yields and Rates Paid (Taxable-Equivalent Basis) (1)(2)

	Quarter ended June 30,							
			2018				2017	
(in millions)	Average balance	Yields/ rates		Interest income/ expense	Average balance	Yields/ rates		Interest income/ expense
Earning assets								
Interest-earning deposits with banks (3)	$154,846	1.75	%	$ 676	204,541	1.03	%	$ 523
Federal funds sold and securities purchased under resale agreements (3)	80,020	1.73		344	77,078	0.91		175
Debt securities (4):								
Trading debt securities	80,661	3.45		695	70,411	3.24		570
Available-for-sale debt securities:								
Securities of U.S. Treasury and federal agencies	6,425	1.66		27	18,099	1.53		69
Securities of U.S. states and political subdivisions (7)	47,388	3.91		464	53,492	3.89		521
Mortgage-backed securities:								
Federal agencies	154,929	2.75		1,065	132,032	2.63		868
Residential and commercial	8,248	4.86		101	12,586	5.55		175
Total mortgage-backed securities	163,177	2.86		1,166	144,618	2.89		1,043
Other debt securities (7)	47,009	4.33		506	48,466	3.77		457
Total available-for-sale debt securities (7)	263,999	3.28		2,163	264,675	3.16		2,090
Held-to-maturity debt securities:								
Securities of U.S. Treasury and federal agencies	44,731	2.19		244	44,701	2.19		244
Securities of U.S. states and political subdivisions	6,255	4.34		68	6,270	5.29		83
Federal agency and other mortgage-backed securities	94,964	2.33		552	83,116	2.44		507
Other debt securities	584	4.66		7	2,798	2.34		16
Total held-to-maturity debt securities	146,534	2.38		871	136,885	2.49		850
Total debt securities (7)	491,194	3.04		3,729	471,971	2.98		3,510
Mortgage loans held for sale (5)(7)	18,788	4.22		198	19,758	3.87		191
Loans held for sale (5)	3,481	5.48		48	1,476	3.65		13
Commercial loans:								
Commercial and industrial – U.S.	275,259	4.16						