CtW Investment Group

January 22, 2008

William H. Goodwin
Member, Risk Committee
Board of Directors
c/o Corporate Secretary
Wachovia Corporation
301 South College Street
Charlotte, North Carolina 28288-0013

Dear Mr. Goodwin:

Wachovia's failure to manage mortgage-related risk cost its shareholders $36 billion in 2007, a 33% decline that wiped out all of the shareholder value created over the last four years. Moreover, these mortgage-risk related losses came despite assurances from the company that it was in a strong position to weather a potential downturn in the housing market, particularly in relation to its 2006 acquisition of Golden West Financial.

With Wachovia's 2008 director election only three months away, we call on you, as a member of the Risk Committee in 2005 and 2006, to describe the actions you took during that period to understand and assess Wachovia's underlying exposure to mortgage risk across its businesses and satisfy yourself that management was taking appropriate steps to control such exposure. Absent a compelling explanation, we intend to recommend that shareholders oppose your re-election at Wachovia's 2008 annual meeting.

The crux of our concern is as follows:

1. By mid-2005 it was apparent that mortgage lenders were loosening lending standards and that an overheated U.S housing market was at risk of collapse. Despite numerous red flags, it appears that management failed to control Wachovia's substantial mortgage risk: In 2005 Wachovia increased its residential mortgage lending by $20.5 billion or 28%, and in 2006 – primarily through the Golden West acquisition – Wachovia's residential mortgage loans increased by $131 billion or 138%. Between the end of 2004 and the end of 2006 mortgage loans increased as a share of Wachovia's total loans from 32% to 53%.

2. Risk Committee members should have recognized that the risks of such a collapse had risen dramatically by late 2005 and thus taken particular care to satisfy yourselves that management was taking steps to monitor and control Wachovia's exposure. Nevertheless, after initially reducing its exposure to mortgage-backed securities early in 2006, Wachovia increased such exposure by $3.7 billion – or 36% -- between the third quarter of 2006 and the second quarter of 2007. Moreover, the Golden West acquisition exposed Wachovia to substantial new risk from declining residential real estate prices, defaults, and foreclosures, given Golden West's exclusive issuance of option adjustable rate mortgage loans ("option ARMs") – which Businessweek described as "nightmare mortgages" – as well as its focus on overheated real estate markets. As Mark Adelson, Head of Structured Finance Research at Nomura Securities, warned in September 2005:

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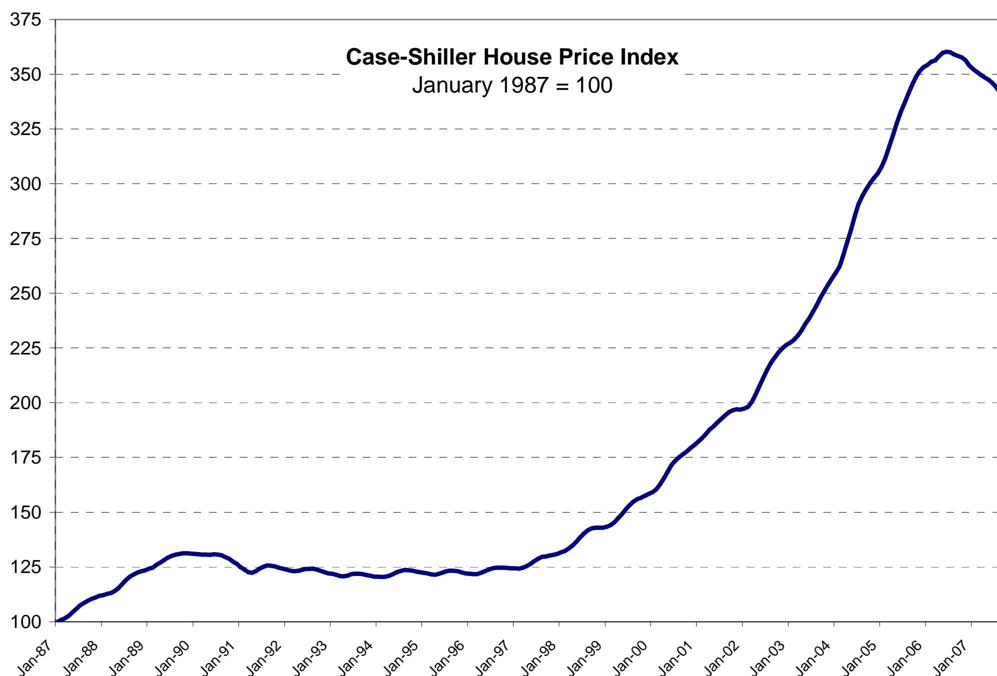
> "Even the possibility of a [housing] bubble burst should lead [investors] to a defensive position." (*Asset Securitization Report,* September 20, 2005).

The CtW Investment Group works with pension funds sponsored by unions affiliated with Change to Win, a coalition of unions representing nearly 6 million members, to enhance long-term shareholder value through active ownership. These funds, together with public pension funds in which CtW union members participate, have about $1.4 trillion in assets and are substantial long-term Wachovia shareholders. We detail our concerns further below.

The Warning Signs Were There

By mid-2005, it was apparent that a housing bubble had developed and that the risks of a severe mortgage downturn had increased dramatically. Fueled by historically low interest rates, the creation of mortgage products targeting less credit-worthy borrowers and abundant liquidity from a booming secondary market for securitized mortgages, home prices had virtually doubled over the previous five years (see below graph).



Housing starts, which had increased every year since 2000, peaked in second quarter 2005. Mortgage interest rates began rising, with the average rate on a conventional 30-year fixed rate loan jumping from 5.6% to 6.7% between June 2005 and June 2006. Mortgage lenders were loosening their lending standards and increasingly using novel loan products.

One need have been an economist or the director of financial services firm with access to these data, however, to know that a national housing bubble had developed and could burst. One need only have read the news to see that a growing number of economists, investment professionals and public policy experts were sounding the alarm:

- On May 27, 2005, economist Paul Krugman of the *New York Times* said he saw "signs that America's housing market, like the stock market at the end of the last decade, is approaching the final, feverish stages of a speculative bubble."
- On June 9, 2005, Federal Reserve Chairman Alan Greenspan, while downplaying risk of a national housing bubble, acknowledged in testimony to the Joint Economic Committee that he saw "signs of froth in some local markets where home prices seem to have risen to unsustainable levels."
- On July 26 2005, *The Wall Street Journal* reported that "Mortgage lenders are continuing to loosen their standards, despite growing fears that relaxed lending practices could increase risks for borrowers and lenders in overheated housing markets." The article cited increases in novel loan products, including interest-only mortgages, option adjustable-rate mortgages and no documentation loans.
- By December 2005, even some CDO traders warned the bubble could burst. Jason Schechter, then head of CDO trading at Lehman Brothers, echoed other participants at the Opal Financial Group CDO Summit when he said: "What concerns me though is: is this liquidity here to stay, or are we at risk for a sizable downturn?" (*Asset Securitization Report*, December 12, 2005)

While Wachovia and many of its peers failed to heed these warnings, a number of firms did take action to reduce their mortgage risk exposure. Goldman Sachs, for example, began aggressively reducing its mortgage-backed securities exposure in late 2006, both by reducing inventory and hedging. Morningstar recently named PIMCO's Bill Gross the best fixed-income fund manager in 2007, lauding him for avoiding exposure to subprime securities and for anticipating the effect that the decline in home prices would have on the broader economy and corporate bonds.

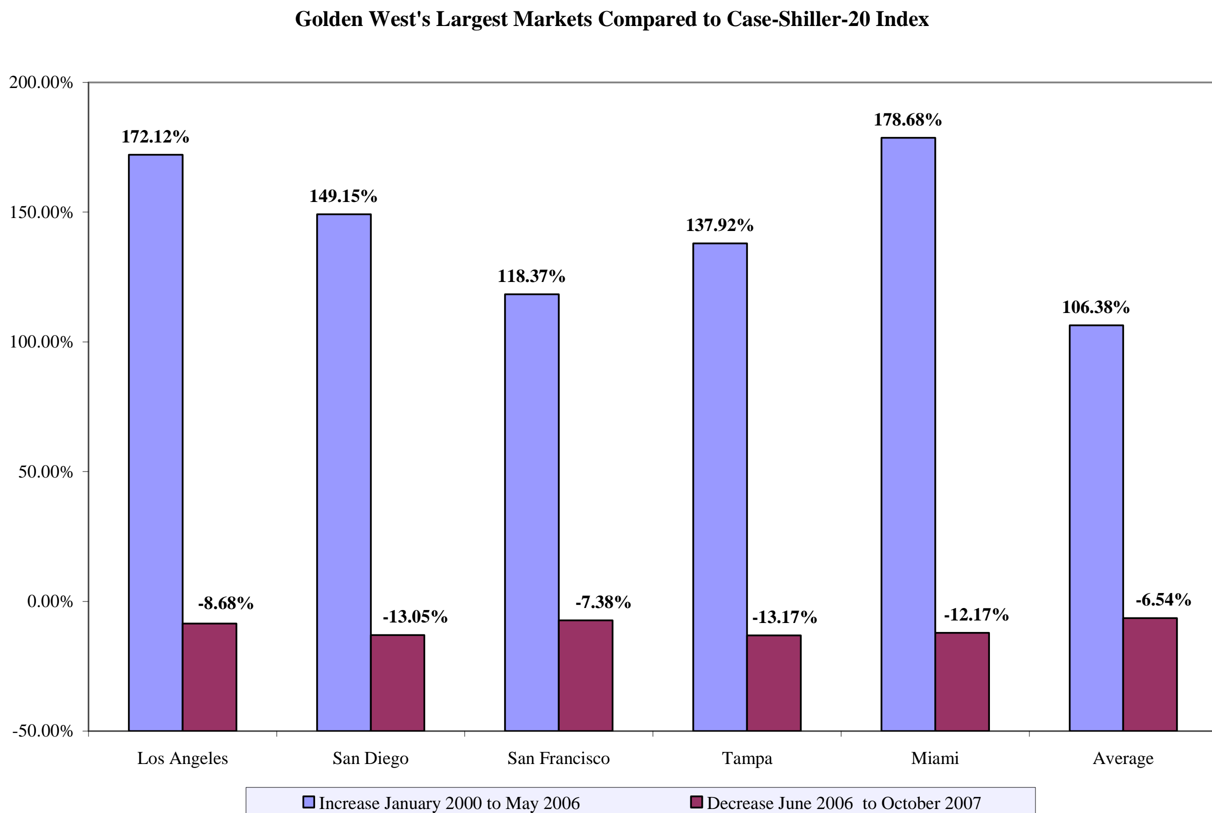
Despite these Red Flags, Wachovia Failed to Control Its Mortgage-Related Risk

As of the end of December, 2007, Wachovia had announced subprime-related write downs and credit losses of $3.9 billion. While it is troubling that Wachovia appeared to increase its exposure to such investments beginning in mid-2006, far larger problems may lurk in Wachovia's considerable residential mortgage portfolio. Not only did Wachovia's mortgage lending through its established banking operations accelerate in 2005 and early 2006, but the decision in May 2006 to acquire Golden West Financial Corporation substantially increased Wachovia's exposure to mortgage-related risk.

According to Wachovia's 8K issued on May 8, 2006 (the day after announcing the Golden West merger), by 2005 99% of Golden West's loan portfolio was comprised of option ARM mortgages. Option ARM mortgages typically allow borrowers to choose one of four payment options: a fully amortizing payment (interest plus principal) on either a 15 or 30 year schedule, an interest only payment, or a minimum payment at a very low "teaser" rate. If a less-than-fully amortizing option is chosen, then the difference between the chosen payment and the fully amortizing payment is added to the value of the loan. As long ago as June 2005 Fitch Ratings was reporting that over half of all option ARM customers experienced negative amortization, and by December 2007 S&P reported that this figure had reached over 75%. Under GAAP, such less-

than-fully amortizing payments may still be booked by the lender at the level of the fully amortizing payment, with the difference recorded as deferred interest: in the first half of 2006, deferred interest comprised nearly 60% of Golden West's earnings.

Moreover, Golden West's loan portfolio was heavily weighted toward markets that had – as of May 2006 – experienced price appreciation exceeding the national average. As of as of December 31, 2005, loans to California homeowners comprised nearly 62% of Golden West's mortgage portfolio, with Florida following at 7%. The graph below illustrates the degree to which these markets were overheated even compared to the national house price bubble:



In addition to the run-up in house prices through the announcement of the merger being steeper than the national average in Golden West's key markets, the subsequent decline has also been steeper than average. Such price declines, which have no doubt continued since October 2007, are particularly troubling for the holders of option ARM debt: the combination of falling prices and increasing loan values (as a result of negatively amortizing minimum payments) makes it ever more likely that borrowers will face "negative equity" – where their loan obligations exceed the expected resale value of their house. S&P has already noted that defaults on option ARM mortgages are increasing and are likely to rise sharply in the coming months.

Wachovia's disclosures to date have not provided any detail either concerning losses incurred after September 30, 2007, or concerning the allocation of mortgage loan losses between Wachovia's historic lending operations and the portfolio acquired from Golden West. But we are

very concerned that mortgage related losses will mount in the future, as house prices continue to decline in the markets to which Golden West was most exposed.

Where was the Risk Committee?

In his 2007 letter to shareholders, Chairman and CEO G. Kennedy Thompson expressed disappointment at "the market's reluctance to embrace our acquisition of Golden West." He further stated that he believed "this reluctance largely stemmed from short-term concerns over the perceived difficulty of combining our business models and fears of a weakening mortgage market." Nevertheless, Mr. Thompson argued that "While these will be challenges in 2007, we considered them thoroughly when we evaluated this acquisition," and that the Golden West acquisition "provided significant opportunities that outweighed any short-term concerns surrounding the weak mortgage market."

While it is the CEO's job to manage overall exposure to risk, the NYSE listing requirements mandate that it is the responsibility of the Audit Committee or other designated committee to review the firm's major financial risk and assess the steps management has taken to control such exposure. The Risk Committee's charter also explicitly empowers the Committee to seek out reports or information from external sources in order to better understand and supervise Wachovia's risk management strategy. Moreover, while directors cannot be expected to understand every technical aspect of an underlying business, they still must acquire and maintain sufficient knowledge and understanding of the company's business to properly discharge their duty of care.

We believe that Wachovia's Risk Committee failed in these duties as they relate to the company's exposure to mortgage-related risk in general and its acquisition of Golden West Financial Corporation in particular. As *The New York Times* reported on December 21, 2007: "This year the leaders of some of the world's most respected financial institutions — leaders who are paid first and foremost to manage risk — have been caught either unaware or uninformed about giant risks their companies took. Their financial engineers concocted securities so complex that even the brainiacs cannot figure out what those investments are worth."

One factor may be the composition of the Risk Committee itself. As you know, three of the six members—Ms. Young, Mr. Richey, and Mr. James—are active CEOs. Given the tremendous time demands of such management jobs, we question whether such directors had the time to effectively monitor Wachovia's exposure to mortgage risk, assess the particular risks inherent in acquiring a lender exclusively focused on option ARM mortgages at the peak of a house price bubble, and fully understand its investments in complex derivates. For this very reason, many institutional investors have proxy voting policies that dictate that CEOs should restrict their service on outside boards.

Additionally, governance analysts have pointed to significant additional concerns with respect to Wachovia's board's independence and willingness to question management. Institutional Shareholder Services (ISS) classifies Mr. James and Mr. Rady as affiliated outside directors, while the Corporate Library classifies Mr. James, Ms. Young and yourself as affiliated directors,

and Mr. Rady as an insider. Overall, ISS gives Wachovia an Corporate Governance Quotient of 22.5 (meaning that 87.5% of S&P 500 companies had superior governance), and the Corporate Library gives Wachovia a "D" rating, citing "high concern" over director conflicts and "very high concern" over executive pay. The Corporate Library also notes that Wachovia directors in 2006 received average compensation of over $198,000, questioning "the board's ability to ensure that executive compensation … is sufficiently performance related" and that "it is possible that a board with this much compensation at stake might not be so quick to stand up and change compensation policy." Misalignment between company performance and executive pay may induce excessive risk taking by the CEO, which only underscores the need for truly independent directors to assess Wachovia's risk management.

Wachovia Shareholders Require a Detailed Explanation

In preparation for Wachovia's 2008 director election, we believe shareholders are entitled to a detailed explanation as to what steps the Committee members took, individually and collectively, to: (1) understand Wachovia's exposure to mortgage risk through both its lending and structuring business and its investments in CDOs, SIVs and other exotic debt instruments; and (2) understand the particular risks entailed in acquiring a large portfolio of option ARM mortgage loans with heavy exposure to overheated mortgage markets at a time when price declines were imminent, and (3) satisfy themselves that management was taking appropriate steps to control such exposure. Among the issues we would like Committee members to address:

- *Internal flow of information*. What information was routinely provided to you by management? How frequently was the information provided? Did the Committee request additional information from management in response to mounting concerns with mortgage-related risk? What additional information did the Committee request and when was it requested? Did the Committee meet regularly with the senior executives at the company with direct responsibility for measuring, analyzing and managing risk? How often did these meetings task place? Who was present at these meetings?

- *Independent assessment of information*. What independent steps did the Committee take to evaluate the information provided by management? Third-party advisors can serve as an important tool for directors to assess the quality of information they are receiving in the boardroom. Which, if any, outside firms were used by the Committee? When were they hired and what role did they play?

- *Committee deliberations and actions*. What additional actions, if any, did the Committee require management to take to control Wachovia's significant mortgage-related exposure? We are particularly interested in deliberations and actions with respect to risk assessment, internal valuation models and hedging strategies. When did these actions occur?

We are not seeking an exhaustive set of documentation, but rather a cogent description of specific steps that you, as an incumbent director on the Risk Committee, took to independently and pro-actively protect the interests of Wachovia shareholders from excessive exposure to mortgage risk.

We look forward to a timely response so that shareholders can properly assess the suitability of your candidacy.

Sincerely,

William Patterson
Executive Director

cc. G. Kennedy Thompson, Chairman, President and CEO
Robert A. Ingram, Chair, Corporate Governance and Nominating Committee