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Regarding a Hearing Before the United States Senate Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs

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Chairman Levin, Ranking Member Coburn and Members of the Committee, thank you for the opportunity to comment on my history with Washington Mutual Bank ("WaMu") and to provide a risk management perspective on some root causes of the U.S. financial crisis.

Before leading the Enterprise Risk Management group at WaMu, I spent more than twenty years working in risk management positions at Royal Bank of Canada in Toronto, Vancouver and abroad, Bank One in Chicago and CIBC in Toronto. I joined WaMu's management team in December 2005 and served as the Chief Enterprise Risk Officer through April 2008.

When I arrived at WaMu, I inherited a risk department that was isolated from the rest of the business and struggling to be effective. The Chief Enterprise Risk Officer position was described to me as an opportunity for WaMu to develop a sophisticated and comprehensive risk management vision and I understood that the regulatory agencies and WaMu's Board of Directors (the "Board") were particularly interested in expanding risk management functions within the company. Thus, during my first few months, I reorganized the department in order to align risk management with the company's business lines by embedding risk managers in each of the four business units. The general function of risk management is to measure, monitor and establish parameters to control risk and to set reserve limits so that the company is prepared for

potential loss. Accordingly, the goal behind the reorganization of the risk group at WaMu was to better utilize risk management expertise within the individual business units and to enable the company to grow responsibly while maintaining a healthy level of well-managed risk.

The company's strategic plan to shift its portfolios towards higher margin products was already in place when I arrived at WaMu in December 2005. Basically, with respect to the mortgage business, this strategy involved a change from traditional mortgage lending with fixed interest rates to alternative lending programs involving adjustable rate mortgages as well as subprime products. The "Higher Risk Lending Strategy" had been conceived a year before my arrival, although I was not informed of the extent of the plan until after I had commenced employment with the company. Under this strategy, senior management decided to decrease the company's exposure to interest rate risk and to increase its exposure to credit risk. To accomplish this, WaMu shifted its focus away from traditional fixed rate mortgages. While these assets give rise to less credit risk, they contain substantial interest rate risk and offer lower returns. At the same time, the bank increased its exposure to subprime assets, option ARM loan products and home equity loans. These products contain a higher degree of credit risk because there is a greater chance that the borrower will default. To compensate for the increased chance of default, the lender charges the borrower a higher spread over cost of funds for the product. This in turn resulted in initially higher returns when these assets were retained on the balance sheet and greater gain on sale when these products were sold into the market than was the case for more traditional mortgage products.

During the first quarter of 2006, I took steps to evaluate and improve WaMu's risk profile. With the decision by senior management to shift to higher margin products, the Risk Management group had a responsibility to measure, monitor and set controls to properly contain risk for the strategy the company had chosen. In order to achieve this, we reviewed the limits and credit policies which had been set for the Retail, Credit Card, Commercial and Home Loans divisions and evaluated how those limits were tracked in order to develop an understanding of how each business line functioned in order to ensure that risk considerations were fully integrated into each business's operations.

The strategic shift to higher margin products was poorly executed at WaMu. During my tenure at the bank, I provided numerous reports to both senior management and the Board which pointed out control weaknesses in the bank. Internal Audit produced a number of reports in this area with ratings of "Requires Improvement" and the Credit Review group, which was charged with reviewing compliance with credit policies, produced metrics which demonstrated deficiencies in the adherence to credit policies. This was particularly true in the case of Long Beach Mortgage Company ("Long Beach") where the quality of underwriting was below standard. Although attempts were made to improve the operations, these efforts were not sufficiently effective. In addition, the deficiencies at Long Beach were a focus of concern for the regulators, who during each annual review, formally requested that the Board take action to address them.

In hindsight, option ARM loans, also known as adjustable rate mortgages, were a significant factor in the failure of WaMu and the financial crisis generally. A borrower with an

option ARM loan can choose from a series of payment options, which range from a full monthly payment of principal plus interest to interest-only payments. The product also allows payments to be made at below market interest rates, which can result in the negative amortization of a loan as the unpaid interest is added back into the principal loan amount over time. In negative amortization situations, the amount eventually due on the loan will exceed the amount originally borrowed. Option ARM home loans depend on housing price appreciation for repayment through re-financing, and are viable in a healthy market where housing prices are constantly on the rise. When housing prices depreciate, option ARMs become problem assets.

By the time I arrived in December 2005, option ARM loans were being originated and securitized in high volume at WaMu. Wall Street had a huge appetite for option ARMs, and thus WaMu could sell these loans as quickly as it could originate them. With an incentive to bundle and sell large quantities of loans as quickly as possible, banks all over the country, including WaMu, became conduits for the securitization and sale of loans to Wall Street. The banking industry began to move away from the traditional model of "originate to hold" towards a new system of banks as conduits. Notably, the ease with which securitized mortgage products could be sold encouraged poor underwriting, and guidelines which had been established to mitigate and control risk were often ignored. Moreover, the source in repayment for each mortgage shifted from the individual and their credit profile, to the value of the home. This philosophy of focusing on the asset rather than on customer considerations ignores the reality that portfolio performance is ultimately determined by customer selection and credit evaluation. Even the most rigorous efforts to measure and monitor risk cannot overcome poor underwriting and origination practices. Relying on the value of the property rather than the customer's credit

profile resulted in an inflationary spiral of housing prices, especially in states like California where the "affordability products" were most widely available.

Another key component of WaMu's higher margin strategy involved efforts to increase the company's exposure in the subprime market, which focused on lending to customers who did not meet the credit qualifications to obtain traditional mortgages. As part of those efforts, Long Beach became a division of Washington Mutual Bank in early 2006. After the integration of Long Beach into the bank, WaMu's subprime portfolio included loans originated by Long Beach as well as subprime loans purchased by WaMu from other subprime lenders. The credit performance of Long Beach-originated loans did not meet acceptable risk standards, and the level of early payment defaults suggested poor customer selection and underwriting operations. The Enterprise Risk Management department set reserves for the loans being held by the company for investment and established measures to monitor and control risk in the portfolio. It had no operational control over Long Beach, including its underwriting and collections functions, nor did it play any role in customer selection or enforcement of underwriting policies and guidelines. Upon review, we determined that Long Beach had outsized risk parameters and we implemented standards to tighten these parameters.

As the company's focus on option ARMs, subprime assets and home equity increased, so too did the need for the Enterprise Risk Management group to have eyes everywhere. In an attempt to keep risk issues in the forefront of senior management decisions, I created the Enterprise Risk Management Committee comprised of all the business and functional heads and established risk committees in each business. A Basel compliant model validation capability was

put into place and a comprehensive Board reporting regime was initiated to ensure the Board was informed on all aspects of risk. A credit modeling group was established within Home Loans as well as a maximum credit limit for the bank's exposure to California where WaMu risk was over concentrated. Additionally, the credit criteria in subprime were tightened. We produced numerous Board level reports regarding the bank's operational capabilities in loan underwriting and reorganized the internal fraud group under Internal Audit. The credit department also produced numerous reports, which were sent to every member of the WaMu Executive Committee and provided detailed information on the credit performance of each loan portfolio. We also implemented a monthly Credit Review meeting with WaMu executives to improve the ways in which current credit trends and portfolio status were monitored and controlled. In short, the Enterprise Risk Management group set fundamental controls designed to mitigate and contain risk at manageable levels, however, the implementation of those controls was the responsibility of the business units.

There were different views among WaMu's senior management about the extent to which the company should increase its exposure in its subprime portfolio. While the Risk Management group sought to tighten controls and encourage higher quality originations, some members of senior management supported a rapid expansion of the company's subprime market share. As the financial market deteriorated, the Risk Management group advised that WaMu should focus on areas with lower risk and stable margins instead of trying to escalate the company's subprime exposure. In the end, WaMu's subprime exposure never reached the percentage envisioned in the 2005 strategy shift. In fact, thanks in part to the tightening of controls and risk parameters,

the volume of new subprime originations at WaMu decreased significantly in 2006 from the 2005 levels and thereafter.

As financial conditions continued to deteriorate in late 2007 and early 2008, I was increasingly excluded from senior executive meetings and meetings with financial advisors where the bank's response to the growing crisis was being discussed. I stopped receiving advance copies of Board meeting materials and was dropped from the Board meeting agendas which were set by WaMu senior management. I felt obliged to share my concerns about the bank's condition and about what I believed were weak operational controls in the bank's credit platform, with the Office of Thrift Supervision ("OTS") and with the WaMu Board. During these meetings, I indicated that the company's loss numbers were increasing at unprecedented rates. Because I was being excluded from certain crucial meetings, I became concerned that neither the regulators nor the Board were seeing up to date loss estimates. In February 2008, I initiated a meeting with a director where I advised the director that I was being marginalized by senior management to the point that I was no longer able to discharge my responsibilities as Chief Enterprise Risk Officer of WaMu. Within several weeks, I was terminated by the Chairman.

In conclusion, let me identify some of the factors that contributed to the decline of the U.S. financial market as well as the failure of Washington Mutual Bank. A confluence of factors came together to create unprecedented financial conditions that the market was not equipped to handle. Due to a lack of regulation and lax lending standards, mortgage brokers operated essentially unchecked and underwriting quality suffered as a result. The banking

industry's focus shifted from customer selection and loan performance to loan production volume as banks became conduits for Wall Street, which could and would securitize whatever mortgage pool the banks originated. Rating agencies and regulators seemed to be lulled into a sense of complacency by the astounding amount of money that was being made and the government-supported enterprises ("GSEs") opened their own risk envelopes and guaranteed and warehoused some of the most risky products on the market.

As the PSI is aware, WaMu was seized by the regulators in September 2008 and the assets of Washington Mutual Bank were purchased by JPMorganChase shortly thereafter. This occurred six months after my departure from WaMu.

Thank you for the opportunity to share my thoughts and experiences. I look forward to the PSI's review of this matter and I am prepared to answer any questions.