Written Statement of Kerry K. Killinger Submitted to the United States Senate

Permanent Subcommittee on Investigations

April 13, 2010

I appreciate the opportunity to contribute to this Subcommittee's investigation of the financial crisis. I sincerely hope that this statement will contribute to the Subcommittee's efforts to better understand the causes of the financial crisis and to propose reforms that will reduce the likelihood of a similar financial crisis in the future.

I was an employee of Washington Mutual for more than 30 years and was honored to be its Chief Executive Officer for 18 of those years. Thanks to the efforts of tens of thousands of Washington Mutual employees, the Bank enjoyed many successes over most of my tenure as CEO as we produced solid financial results and a growing customer base, and received numerous awards for customer service and corporate philanthropy. However, the financial crisis, which hit in full fury in the second half of 2007, and the seizure and sale of the Bank in September of 2008, were devastating to Washington Mutual, its customers, employees, investors, and communities. As CEO, I accept responsibility for our performance and am deeply saddened by what happened.

Overview

I want to start off by briefly addressing three topics. The first is Washington Mutual's role in developing and marketing higher risk residential loan products. The second is the Company's role as a portfolio lender and as a participant in the secondary mortgage market. The third is the unnecessary seizure and bargain sale of Washington Mutual.

Regarding the first topic, Washington Mutual was primarily a consumer banking organization with 2,257 retail banking offices offering checking, savings, investment, credit card, small business and residential lending products. Its residential lending was overwhelmingly to prime borrowers. The Company offered a full range of fixed and adjustable rate products and its loan portfolio performed well over many years with loss rates well below 1%. Approximately 90% of the Company's residential first loan portfolio had a loan-to-value ratio at origination ("LTV") of 80% or less.

Higher risk residential loan products like Option ARMs, home equity loans and subprime loans had been offered by Washington Mutual and many of its competitors for long periods of time. These products were not new and exotic, nor developed during the housing boom. Option ARMs have been core portfolio products of most West Coast thrifts since the 1980s and millions of customers had good experiences with this product. Home equity loans have been core portfolio products for most banks for decades and were an important tool for people to start small businesses, finance their children's education, or finance home improvements. Subprime mortgage products had been around since the early 1990s and helped expand home ownership for many underserved communities.

Beginning in 2005, two years before the financial crisis hit, I was publicly and repeatedly warning of the risks of a housing downturn. Unlike most of our competitors, we aggressively reduced our residential first mortgage business. From 2003 to 2007, the Company reduced its residential first mortgage originations by 74%, thus reducing its market share of total residential first mortgage originations by about 50%, from about 12% to about 6%. The Company reduced its Home Loans group staffing by about 50% over this period.

During this time, Washington Mutual's market share for most higher risk residential loan products also declined dramatically. For example, the Company's market share of subprime loan originations declined from only 6% to less than 3%, and its market share of Option ARM originations also declined over this period. Option ARM originations in 2007 decreased by about 65% from its peak in 2004. Attached Exhibits 1 through 4, which are based on data from Inside Mortgage Finance, show these trends in greater detail. It is particularly noteworthy that Washington Mutual was decreasing its market share at a time when most large competitors were increasing or maintaining their market share of originations.

The Company originated residential mortgage products through its own employees (retail) and through third-party mortgage brokers (wholesale and correspondent). Home equity loans were primarily originated through our own employees. Subprime mortgage loans (through our Long Beach Mortgage subsidiary) were primarily originated through third-party mortgage brokers. Residential first mortgage loans were originated through a combination of employees and third-party mortgage brokers. As a result of changing market conditions, we reduced and then eliminated loan originations through third-party brokers and correspondents.

Our Long Beach Mortgage subsidiary was a small part of our business that had been declining since 2005. We initially entered the subprime business in 1999 to serve a growing and underserved market. However, due to increasing concerns over the housing market and third-party mortgage brokers as well as our own operating issues, we greatly reduced originations in 2006 and shut down this business in 2007.

Washington Mutual had well-defined and strong corporate values and clear policies of fair dealing with our customers. The Company adopted its Responsible Lending Principles in 2001 and expanded them in 2006 (Exhibit 5) to include credit cards when it entered that market. These Principles, which were strongly endorsed by community groups, reinforced the Company's commitment to having a broad range of appropriate products with fair pricing for all prime and subprime customers. These Principles were reinforced with the Company's values statement, which included that "ethics of absolute fairness, honesty and integrity guide everything we do and we offer our customers products and services which fit their needs and provide great value." I spent much of my time communicating our core Company values to our employees throughout the country. Employees were expected to practice our core values, and violations led to reprimands and terminations. This is why I am particularly angered when I read that any customer might have been sold an inappropriate product.

Consistent with our core values, Washington Mutual strived to help its customers through difficult times. The Company set up an emergency fund to help customers with medical and other emergencies. The Company set up a $2 billion fund to help subprime customers refinance into fixed rate loans in 2007. We were a leader in helping customers modify their Option ARM loans or extend their reset periods when the housing crisis accelerated in 2008. The Company participated in virtually every industry and government program effort to help borrowers refinance or modify their loans. The Company consistently received outstanding Community Reinvestment Act ("CRA") ratings and received numerous awards for its community lending.

The boom and subsequent severe downturn in the housing market was caused by the convergence of many factors. The boom was fueled by exceptionally low interest rates, public policies encouraging home ownership, tax benefits for borrowing against the value of a home, expansion of the GSEs (Freddie Mac and Fannie Mae) and Wall Street, abundant mortgage financing and speculators wanting to participate in the housing boom. The severe downturn was caused by declining housing prices which in combination with a freezing of the capital markets fueled a vicious cycle of delinquencies, foreclosures and further price declines.

Although we had warned of the risks of a housing downturn, we, like virtually everyone else, did not foresee the severity of the downturn. Housing price declines of 40% or more in many of our core markets led to an unprecedented surge in loan delinquencies and foreclosures. Many customers faced "negative equity" as the value of their homes plummeted well below their mortgage balances. Virtually all loan products (fixed and adjustable rate, limited documentation and full documentation, prime and subprime) experienced rapidly escalating delinquencies and foreclosures. Delinquencies and foreclosures of higher risk loan products such as option ARMs, home equity and subprime loans were especially impacted because the recession and rising unemployment magnified the effects of declining housing prices.

Moving on to the second topic, Washington Mutual originated residential loans both to hold in its own portfolio and for sale to the secondary markets. Historically, the

Company held most home equity and Option ARM loans it originated in portfolio. Subprime loans originated through our Long Beach Mortgage subsidiary were generally sold into the secondary market in part because banking regulations significantly limited buying loans from affiliates. The Company also sold most prime fixed rate loans due to their high level of interest rate risk. Intermediate term and various adjustable rate loans were either retained in our portfolio or sold to the secondary market depending on market conditions and the Company's plan for deploying capital.

In recent years prior to the financial crisis, as the secondary mortgage market grew much larger, the residential first mortgage market became dominated by unregulated mortgage brokers originating loans to be sold to the GSEs and Wall Street. Lenders who originated loans and held them in portfolio became a diminishing factor as it became difficult to compete with the GSEs and Wall Street, which had ever-growing appetites for loans at attractive prices. This was in part due to their ability to operate on much lower levels of capital than traditional bank portfolio lenders.

The GSEs and Wall Street also expanded their appetite for all types of prime and subprime loans. This was particularly evident with option ARM loans, and an active secondary market developed for this product. This led to a surge in broker originations of that product. Increasingly, these secondary market purchasers dictated the underwriting parameters for mortgage loans. They specified what level of risk they would purchase in return for increased risk-adjusted return, and their specifications defined the loan products being offered.

These developments in the mortgage origination business, along with our cautious outlook for housing, led us to take a number of significant actions including: reducing our residential first mortgage originations; closing home loan centers; cutting our Home Loans staffing by 50%; selling 30% of our loan servicing portfolio; reducing and then eliminating broker and correspondent lending; and eliminating certain of our product offerings. Although the Washington Mutual Board of Directors had adopted a new five-year strategic plan in 2004 that contemplated growing higher risk loan portfolios, we deferred the implementation of many aspects of our strategic plan, and instead returned capital to shareholders through cash dividends and share repurchase. This was particularly evident in the subprime channel mortgage portfolio, where we decreased the portfolio in contrast to our specific long-term strategic plan to grow the portfolio.

Moving on to the third topic, I believe Washington Mutual should not have been seized and sold for a bargain price. There is no question that the Company suffered from rising loan losses, but the Company was working its way through the crisis by reducing operating costs, raising over $10 billion of additional capital, and setting aside substantial loan loss reserves. The Company's Tier I capital ratio was a strong 8.44% at the end of the second quarter of 2008. The Company also had an outstanding retail banking franchise that not only provided substantial core profitability but also would have been of enormous value to a number of potential acquirers.

When I left the Bank in early September of 2008, its capital greatly exceeded regulatory requirements for a well-capitalized bank. Deposits were stable, sources of liquidity appeared adequate, and our primary regulator, the Office of Thrift Supervision ("OTS"), had not directed us to seek additional outside capital or find a merger partner.

It was with shock and great sadness that I read of the seizure and bargain sale of Washington Mutual on September 25, 2008. I recognize that policy makers and Regulators had no blueprint for dealing with the worldwide financial crisis that developed in the aftermath of the collapse of Lehman Brothers. But I believe that Washington Mutual's seizure was unnecessary, and the Company should have been given a chance to work its way through the crisis. I also believe it was unfair that Washington Mutual was not given the benefits extended to and actions taken on behalf of other financial services companies within days of the Company's seizure, such as the following:

- The FDIC's insurance limit increase to $250,000;

- The FDIC guarantee of bank debt;

- The Federal Reserve injection of liquidity and purchase of assets;

- The Treasury Department announcement of favorable treatment of tax losses; and

- Injection of capital into all major banks through the Troubled Asset Relief Program.

The unfair treatment of Washington Mutual did not begin with its unnecessary seizure. In July 2008, Washington Mutual was excluded from the "do not short" list, which protected large Wall Street banks from abusive short selling. The Company was similarly excluded from hundreds of meetings and telephone calls between Wall Street executives and policy leaders that ultimately determined the winners and losers in this financial crisis. For those that were part of the inner circle and were "too clubby to fail," the benefits were obvious. For those outside of the club, the penalty was severe.

In my view, the actions taken by policymakers reflect a vision of a banking industry dominated by large Wall Street banks. Consumer-based banks like Washington Mutual were not included in this vision, and consequently were not extended the same protections. I believe this was a mistake. I fear that consumers will ultimately pay the price of this vision through less competition, higher fees, and lower interest rates on their deposits.

Now that I have briefly covered these three topics, I would like to elaborate on what we did at Washington Mutual to prepare for a housing downturn and later respond to the financial crisis. I will then turn to some policy recommendations for your consideration.

Washington Mutual was a bank for families and small businesses

For its entire history, Washington Mutual was dedicated to serving the needs of "every-day" individuals, families, and small businesses. We provided an alternative to large Wall Street banks. Our roots were centered in providing well-priced products with friendly service. The Company did not focus on the affluent for its core customer base, and it was the antithesis of the large Wall Street banks that made most of their profits from large corporate relationships, securities trading, and investment banking. Washington Mutual was a Main Street bank focused on serving customers with basic checking, savings, and lending products. The Bank pioneered consumer-friendly services such as free checking, surcharge-free ATMs, and free credit score reports. The Company historically was focused on serving communities in the Pacific Northwest and, although we eventually developed a nationwide footprint, the majority of our customers lived on the West Coast.

The Company's largest business unit by far was Retail Banking, which provided checking, savings, and investment and loan products to millions of consumers and small businesses. By the end of 2007, we had 2,257 branches serving customers with 19.4 million transaction accounts. Measured by revenues for 2007, our largest business was Retail Banking with $8.3 billion, followed by Card Services at $4 billion, Home Loans at $1.9 billion, and the Commercial group at $850 million.

Washington Mutual's principal loan product offerings were residential first mortgages, home equity loans, credit cards, multi-family loans, commercial real estate loans, and small business loans. I describe some of these loans in more detail in the next section. Our banking units were Federal Savings institutions, which were required to have 65% of their assets in qualifying thrift assets such as residential mortgages, home equity loans, multi-family loans, and small business loans. This requirement led to the historic concentration in certain asset categories by Washington Mutual and other thrifts. From a national public policy perspective, the thrift charter was considered appropriate because of the country's goal of increasing home ownership and the low historic loss rates on residential lending.

Washington Mutual's primary regulator was the OTS. The OTS had on-site examiners who examined the Company on a continuous basis. The OTS interacted with the Company's personnel from many levels of the organization and annually presented their examination findings to the Board of Directors. The regulators routinely examined asset quality, loan loss reserves, capital adequacy, liquidity, earnings, quality of management, product offerings, customer service, business strategies, and operating plans. They also examined our compliance with various laws and regulations and assigned us a CRA rating. We consistently received the highest CRA rating of "outstanding."

Washington Mutual's residential mortgage products

Washington Mutual offered a broad range of fixed and adjustable rate residential lending products to its customers. Fixed rate mortgages offered customers the benefits of fixed payments and a stable interest rate. Their primary disadvantage, as noted in a speech by former Federal Reserve Chairman Alan Greenspan in 2004, was that the interest rate charged on fixed rate mortgages is often substantially higher than the rate charged on adjustable rate products. Fixed rate mortgages are particularly appealing to borrowers in periods of low long-term interest rates such as occurred in 2002 and 2003.

The Company also offered a full range of adjustable rate mortgage products. These typically provided borrowers the advantage of lower interest rates and lower initial payments but had the disadvantage of changing interest rates and a possible increase in future payments. Many customers preferred adjustable rate products because they anticipated staying in their homes for only a few years, and they would prefer the benefit of lower payments more than the benefit of locking in an interest rate for 30 years.

Among the adjustable rate mortgage products offered by the Company were Option ARMs. Contrary to some public perceptions at this time, these were not new and exotic products created during the housing boom in the 2000s. In fact, we viewed this product as one of our core portfolio products because Washington Mutual, along with most thrifts on the West Coast, had successfully offered Option ARMs to consumers since the early 1980s. The Company's Option ARM product had an attractive interest rate tied to a moving one-year treasury yield and it was not offered through its Long Beach Mortgage subsidiary. Borrowers had the flexibility to choose from four payment options. If the borrower chose to make the very minimum payment, the mortgage balance could increase. This "negative amortization" is the difference between the actual payment and the interest rate charged on the loan.

Option ARM loans had historically performed well, with low delinquency rates over long periods of time. And in prior regional housing downturns (for example as experienced in California in the early 1990s), consumers tended to limit the amount of negative amortization by making payments above the minimum.

But in the recent housing downturn, more consumers chose to make only the minimum payments, resulting in negative amortization and increasing the likelihood that their loan payment would be recast to a higher level. Even so, as of June 30, 2008, the Company's Option ARM portfolio balance had only grown by less than 4% above the original loan amount due to negative amortization. The much bigger problem facing Option ARM customers (as well as borrowers using other loans products) was housing price declines of 40% or more in some of Washington Mutual's key markets. With declining equity in their homes, customers were not able to refinance their mortgages or sell their homes.

As discussed in more detail below, in light of changing market conditions, the Company significantly reduced its originations of new Option ARMs and expanded its loan modification initiatives, a process that started even before the financial crisis escalated in the second half of 2007 and 2008. Washington Mutual significantly reduced its originations of Option ARMs in 2006, 2007 and 2008. New Option ARM loan originations declined from $63.3 billion in 2005 to $42.6 billion in 2006 to $23.9 billion in 2007 and to only $500 million in the first half of 2008. They were only 25% of total loan originations in 2005 and were reduced to 21% in 2006, to 16% in 2007, and to less than 1% for the first six months of 2008.

Washington Mutual also originated and serviced subprime residential mortgages beginning with its acquisition of Long Beach Mortgage in 1999. Subprime loans facilitated the expansion of home ownership in the United States, and many subprime borrowers were able to qualify for prime loans within a few years because of their improved credit performance and appreciated equity in their homes. The Company entered this business in order to serve the broadest possible range of customers and to help bring better products and pricing to a market historically dominated by unregulated lenders. Our expectation was that the subprime industry would evolve to a much more regulated industry.

Long Beach was one of our smallest operations. It generally provided adequate financial returns over the first few years we owned it. However, it had operating issues that were disappointing and resulted in changes to its executive management and reorganization of its operations. We ultimately concluded that Long Beach should be integrated into our Home Loans group and overseen by the Home Loans group's executive management team. However, due to growing concerns over the housing market and third-party mortgage brokers, as well as our own operating issues, we greatly reduced our subprime originations in 2006 and shut down the subprime origination business in 2007.

All of our residential loan portfolios (prime, subprime, and home equity) generally performed very well over many years. Historically, loan losses were well under 1% per year for these products, and losses were highly correlated with LTV ratios and FICO scores. Other factors such as documentation requirements, adjustable rate versus fixed rate, conforming versus non-conforming, and broker versus retail originations were less predictive of loan performance. Washington Mutual's emphasis on LTV ratios of 80% or less certainly helped keep its loss rates for the various portfolios remaining well within targeted ranges over many years.

However, as I describe below, virtually all residential loan products offered by financial institutions and mortgage brokers were impacted by the severe price reduction that ultimately hit the housing market. Even conservatively underwritten products (low LTV and high FICO score) experienced sharply rising delinquencies when housing prices fell. Virtually all categories of loans – prime, subprime, fixed rate, adjustable rate, and home equity – experienced rising delinquencies and loan losses.

The growth in the secondary market

The overwhelming majority of Washington Mutual's home loans were made to prime customers seeking mortgages with an LTV of 80% or less at the time of origination. The Company originated loans to hold in its portfolio for investment, but it also originated loans for sale to the GSEs, and later to other financial institutions on Wall Street.

Fixed rate mortgage originations were generally sold into the secondary market because these loans presented too much interest rate risk to the originating bank. Interest rate risk is the risk that an increase in interest rates will significantly reduce the value of those loans held on the balance sheet. In the late 1970s and early 1980s, before it became standard practice for thrifts to sell fixed rate loans into the secondary markets, many thrifts with large holdings of long-term fixed rate mortgages suffered huge losses when interest rates rose significantly. Regulators subsequently discouraged thrifts from holding long-term fixed rate loans on their balance sheets in order to limit the amount of interest rate risk. As a result, Washington Mutual held mostly home equity and adjustable rate residential loans in portfolio because they provided satisfactory returns and carried only modest interest rate risk.

The growth in the private secondary market was driven by Wall Street investment banks, hedge funds, and other financial institutions. Purchasers in the private secondary market would buy loans from mortgage lenders and brokers. They would pool the loans and securitize them into mortgage-backed securities, and then sell them to investors seeking higher yields. Continued low interest rates spurred the growth in these securities as investors sought higher returns. Purchasers of loans originated by mortgage brokers and lenders set the standards for what types and levels of risks they wanted to buy in return for the potential of increased returns.

As the housing market heated up, the GSEs and Wall Street expanded their product offerings. Wall Street's growing appetite for these products led to a vast influx of unregulated mortgage brokers. Fannie Mae and Freddie Mac became a growing factor in the subprime and affordable housing markets. Regulatory and Congressional policy encouraged and even required these GSEs to devote more of their resources to purchasing subprime loans to help people in underserved communities and borrowers with lower incomes.

The GSEs also became large purchasers of our Option ARMs. We chose to sell most of our Option ARM originations to the GSEs in 2006 and 2007 because they were paying attractive prices, and we believed that returning capital to shareholders through dividends and share repurchase made more sense than accelerating asset growth.

Loans originated through Long Beach Mortgage were generally sold to the secondary market. Washington Mutual was significantly limited in its ability to buy loans from affiliates. Separate from Long Beach Mortgage originations, the Company purchased loans to be held in portfolio from other subprime originators. These loans were re-underwritten to ensure conformity with our internal credit risk guidelines.

Management structure and compensation plans

Because of our size and complexity, with about 60,000 employees operating throughout the United States, as CEO I relied on the management teams within each business unit to run their respective businesses as well as to manage their risks. I also relied on key executive officers to provide leadership over critical corporate support services such as Human Resources, Finance, Legal, Corporate Development, Information Technology, and Enterprise Risk Management. We were organized around the four major business units, each of which had a president and executive management team to oversee their operations. For risk management, each business unit had a chief risk officer who reported jointly to the business unit president and the Company's chief enterprise risk officer. This dual reporting structure was similarly utilized for many of our key corporate support activities.

For many years, I retained the titles of President, CEO, and Chairman of the Board. In 2004, the directors and I decided that the Company had become sufficiently complex to justify having a separate President and Chief Operating Officer to oversee the day-to-day operations of the organization. The CEO function required extensive travel to visit branches and support facilities, and to attend various industry, regulatory, and investor meetings. Because the Board wanted me to have more time to focus on the Company's strategic vision, we made a decision to separate the position of CEO from the President and Chief Operating Officer. Under the new structure, the four major business unit presidents and certain corporate support positions (e.g., administrative services and informational technology) reported to the President and Chief Operating Officer. Those executives who reported to me included the President and Chief Operating Officer and the heads of Finance, Human Resources, Legal, and Enterprise Risk Management.

Washington Mutual's executive management compensation plans encouraged long-term over short-term performance. These plans, which emphasized equity ownership through stock options, restricted stock and performance shares, were built around multi-year (three to ten years) performance that encouraged sustainable growth. The plans were overseen by a Board committee of independent directors who were devoted to implementing fair, balanced programs that incorporated best practices. The committee hired one of the nation's top compensation consultants to help with the development and oversight of senior management compensation programs to attract and retain top-tier talent.

Because the majority of top executive compensation at Washington Mutual was tied to long-term performance, most executives, including myself, retained the majority of their stock and stock options. Because I fully believed in the Company and that it would work its way through the crisis, I maintained nearly all of my stock holdings and deferred diversifying my holdings. When Washington Mutual was seized and sold for a bargain price, the value of these holdings became worthless. I know how little consolation it must be, but I am deeply pained whenever I think about how many of our hard-working employees and other investors similarly lost the value of their Washington Mutual investments.

Risk management and strategic planning

Prior to 2002, Washington Mutual managed its key risks primarily through its business units and support groups. Because of the Company's growth and increasing complexity, I decided that we should create a new Enterprise Risk Management group to oversee and manage all key risks throughout the Company. My vision was to make risk management a priority for the Company and to bring the oversight of all key risks such as interest rate, operating, compliance and credit under one group. The head of this group, the Chief Enterprise Risk Officer, reported directly to me and was made a member of the Company's executive committee. By 2007, over 1300 employees were involved in enterprise risk management at the company.

Deciding whether to grow originations of certain mortgage products, or whether to purchase them and hold them for portfolio, involved various risks. We set up processes that would allow us to manage (rather than eliminate) these risks within guidelines established by management and the Board. Our risk management function was the responsibility of both the business units and our Enterprise Risk Management group. We had chief risk officers within each business unit, and each had dual reporting relationships, meaning that the business unit's chief risk officer reported both to its respective head of the business unit and also to the Chief Enterprise Risk officer for the Company.

To help the Company frame its strategic direction, the Washington Mutual Board had adopted five-year plans beginning in 1990 after input from management. After successfully completing three such planning cycles, in mid-2004 the Board approved a new plan for 2005 through 2009. The strategic plan envisioned continued growth of retail banking offices, increased asset diversification (including the potential to enter the credit card business), expansion of multi-family lending, expansion of subprime lending, a reduction in the amount of interest rate risk, and an increase in the credit risk retained on the Company's balance sheet. Around this time, the OTS and other regulators began advocating for the adoption of a new system or model to assess the capital adequacy of banks to better match a bank's required capital with the risk in its assets. This model, referred to as "Basel II," was intended to be an international standard applicable to institutions both in the United States and abroad. Basel II essentially attempted to quantify the risk associated with every type of asset held by a bank, and then quantify the amount of capital the bank should hold against that risk. Under Basel II, residential assets had low capital requirements because of their historically low risk.

Our strategic plan was reinforced by Basel II and other economic capital analyses that showed that the Company had significantly more capital than was justified by the credit risk being held on its balance sheet. We were concerned that inefficient use of capital would make the Company vulnerable to takeover by foreign and domestic companies that often operated on much lower levels of capital or had better optimized their retention of credit risk.

There were many areas of higher risk lending and investing where Washington Mutual chose to limit or avoid exposure. The Company had minimal to no exposure in some higher risk lending products such as leveraged buyout loans, shared national corporate credits, international loans, below investment grade bonds, unsecured consumer finance, corporate lending, automobile financing, leasing, and highly leveraged transactions. We had minimal securities trading operations and had little or no participation in credit default swaps, structured investment vehicles, collateralized debt obligations, and collateralized loan obligations. Instead, the Company's credit risk was centered in secured real estate financing (residential and multi-family) and credit card receivables.

Deferring full execution of the strategic plan and actions prior to the financial crisis

Soon after the 2004 five-year plan was adopted, we became concerned with risks in the economy, capital markets, and the housing market. We also became concerned with what appeared to be growing risks in leveraged buyout financing, commercial real estate prices, commodities prices, stock market prices, and low credit spreads available on many loans. As a result of these concerns, the Company did not execute on plans to grow the subprime portfolio, and similarly limited asset growth in other categories. Instead, the Company increasingly returned capital to shareholders through share repurchase and cash dividends.

The Company was one of the first in the industry to recognize the risks of a housing downturn, and we took a number of actions to reduce the Company's exposure to the housing market. Beginning in 2005, I publicly discussed my concerns about a potential correction in the housing markets. My personal outlook was more conservative than that of most economic forecasters at the time, including the chairman of the Federal Reserve. But I did not predict the convergence of factors that led to the dramatic nationwide downward spiral in housing prices. Indeed, at that time, most forecasters expected a modest decline in housing prices. A significant decline on a nationwide basis was unprecedented in our modern economy and had not happened since the Great Depression. Even through the first half of 2007 it appeared that a correction in home prices was more likely to be orderly and would not result in a severe recession.

The following actions were taken to reduce the Bank's exposure to a housing market correction:

- Closed all home loan centers where the Company did not have a retail banking presence;
- Decreased the subprime mortgage channel portfolio;
- Sold off subprime residuals for 2004 and 2005 originations;
- Reduced and then eliminated broker and correspondent lending;
- Sold 30% of our loan servicing portfolio;
- Sold the majority of new Option ARM originations;
- Tightened many underwriting guidelines;
- Eliminated certain subprime products and ultimately closed originations through that channel; and
- Materially reduced prime and subprime originations.

These defensive actions decreased Washington Mutual's staffing in the Home Loans Group by over 50% from 2003 through 2007. The net result of these actions was a 74% reduction in Washington Mutual's residential first mortgage originations from 2003 through 2007, and a 50% reduction in its market share.

As mentioned earlier, Exhibits 1 through 4 to this statement reflect how Washington Mutual reduced its market share and total originations in all major residential first mortgage categories. Adjustable rate, Option ARMs, subprime loans, retail channel originations, and wholesale originations all declined over this period. Washington Mutual reduced its share of total mortgage originations from about 12% to about

6% according to industry data provided by Inside Mortgage Finance. For subprime originations, the Company's share declined from about 6% to about 3%.

The Exhibits also reflect other important facts: 1) Washington Mutual reduced its market share over this time period while many of the other major lenders were maintaining or increasing their market share; and 2) the Company began to reduce its originations and market share well before the financial crisis escalated in the second half of 2007.

Additional statistical information about our loan portfolio reflects Washington Mutual's approach to its home lending. About 94% of the loans held in Washington Mutual's $103 billion residential first mortgage loan portfolio at June 30, 2008, had an LTV at origination of 80% or less and an average FICO score above 700. The $59 billion home equity portfolio had an average combined LTV at origination of only 73% and an average FICO score of 731 for this period. And the $16 billion subprime channel portfolio had an average LTV of 80% and an average FICO score of 642 for this period.

In retrospect, although Washington Mutual took more defensive actions than did many of its competitors, had we foreseen the magnitude of the housing collapse, we would have undertaken more draconian measures. Such measures, of course, would have presented other issues such as the Company's CRA rating and its commitment to serving its customers and communities.

The Financial Crisis

In the summer of 2007, the mortgage markets experienced unprecedented volatility. The Federal Reserve had continued with its course of raising interest rates through 2006 and the first half of 2007. In part because of this tightening, by the second half of 2007, credit markets were drying up and borrowers were having much more difficulty refinancing their home loans. Homeowners who had fallen behind on mortgage payments were unable to refinance their mortgages, and were forced to sell their homes. This caused housing price declines to accelerate even further because new housing inventory was flooding the market at a time when purchasers were finding it ever more difficult to find mortgage financing. This downward spiral ultimately led to falling housing prices, rising delinquencies and foreclosures, massive closures of mortgage brokerage and mortgage banking operations, and plummeting market values of mortgage-backed securities.

Unfortunately, policy leaders were slow to recognize the deterioration in the housing and credit markets in 2007. In March of 2007, the Chairman of the Federal Reserve said that "the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained." And in June of that year, Treasury Secretary Paulson predicted that the crisis in the mortgage markets "will not affect the overall economy."

The primary driver of Washington Mutual's accelerating loan delinquencies and loss rates in the second half of 2007 and 2008 was the plunge in housing prices in many key markets served by Washington Mutual. The Company's primary retail banking footprint, which included California, Florida, Arizona, and Nevada, was hit especially hard. Many markets served by the Company experienced house price declines of 40% or more.

What started off as a fairly orderly correction suddenly fell into a downward spiral of declining housing prices when numerous factors converged. A vicious cycle erupted where declining housing prices led to rising foreclosures, which led to rising housing inventories, which in turn led to further housing price declines. Also fueling the downward cycle was a slowing economy, rising unemployment, and fewer sources of refinancing. The second half of 2007 and 2008 were cataclysmic for consumers and all those serving the mortgage and housing market. All types of residential loans across the industry performed poorly in this unprecedented environment. Fixed rate, adjustable rate, limited documentation, full documentation, prime, subprime, first mortgages and second mortgages all produced poor risk-adjusted returns for lenders.

Many have tried to identify a simple cause for the boom and the subsequent severe downturn in the housing market. The reality is that there is no simple or single cause. Many factors converged: exceptionally low interest rates; abundant mortgage financing available to broader categories of borrowers; public policies encouraging home ownership; tax benefits for consumers to borrow against the value of their homes; expansion of the GSEs and Wall Street in providing mortgage financing; and consumers and speculators wanting to participate in the housing boom. The severe downturn was caused by declining housing prices that, in combination with a freezing of the capital markets, fueled a vicious cycle of delinquencies, foreclosures, and further price declines.

Washington Mutual had sufficient capital and liquidity

While clearly challenged by the much-worse-than-expected housing downturn, Washington Mutual was well-positioned with sufficient capital and liquidity. We had raised $2.9 billion in additional capital through a convertible preferred stock offering in December 2007.

In the spring of 2008, after considering a range of strategic alternatives, we raised $7.2 billion in private capital from investors including Texas Pacific Group. Our primary regulator, the OTS, was very supportive of this capital raise. As a result of this financing, all regulatory capital ratios greatly exceeded standards for well-capitalized banks and holding companies. For example, as of June 30, 2008, the Company's Tier I ratio, the ratio of the Company's core equity to its core assets, had increased to 8.44%.

Washington Mutual also had substantial sources of liquidity. The Company was primarily funded with retail customer deposits and collateralized Federal Home Loan Bank advances. As of June 30, 2008, the Company estimated that it had about $50 billion of readily available liquidity.

The Washington Mutual Board decided to replace me with a new CEO in the beginning of September of 2008. At the time I left the Company, Washington Mutual's capital greatly exceeded regulatory minimums, deposit flows were stable, sources of liquidity appeared satisfactory, and the OTS had not directed us to raise additional outside capital or to seek a merger partner. Because regulators normally would go through a process of escalating concerns through various directives and enforcement actions prior to taking such draconian actions as forcing the sale or seizing of a bank, I believed that the Company was in a relatively good position to survive the crisis.

It was, therefore, with shock and great sadness that I read of the seizure and bargain sale of Washington Mutual on September 25, 2008. The Company reportedly experienced a sizeable loss of deposits following the Lehman Brothers collapse in mid-September. But it was also reported that deposit flows were stabilizing, and that the Company was actively working on new sources of capital when it was quickly seized.

I believe that Washington Mutual should have been given a chance to work its way through the crisis. I also believe it was unfair that Washington Mutual was not given the benefits extended to and actions taken on behalf of other financial services companies within days of Washington Mutual's seizure, such as the following:

- The FDIC's insurance limit increase to $250,000;
- The FDIC guarantee of bank debt;
- The Federal Reserve injection of liquidity and purchase of assets;
- The Treasury Department announcement of favorable treatment of tax losses; and
- Injection of capital into all major banks through the Troubled Asset Relief Program.

The unfair treatment of Washington Mutual did not begin with its unnecessary seizure. In July 2008, the SEC determined that many large Wall Street firms should be protected from abusive short selling when it issued a list of more than a dozen stocks that could not be shorted. Surprisingly and inexplicably, Washington Mutual was excluded from this list. The Company was similarly excluded from hundreds of meetings and telephone calls between Wall Street executives and policy leaders that ultimately determined the winners and losers in this financial crisis. For those that were part of the inner circle and were "too clubby to fail," the benefits were obvious. For those outside of the club, the penalty was severe.

In my view, the actions taken by policymakers reflect a vision of a banking industry dominated by large Wall Street banks. Main Street consumer-based banks like Washington Mutual were not included in this vision, and consequently were not extended the same protections. I believe this was a mistake. I fear that consumers will ultimately pay the price of this vision through less competition, higher fees, and lower interest rates on their deposits.

Postscript

As I reflect back on my tenure and especially my last few years at Washington Mutual, there are many things we did well to prepare the Company for a slowdown. But when the financial crisis swung into full force, virtually all financial services companies, including Washington Mutual, were hit much harder than anyone had anticipated. Ultimately, companies with large residential lending portfolios were greatly impacted. Most large mortgage companies and thrifts were merged or seized by the regulators. Hundreds of commercial banks were merged or seized. Fannie Mae and Freddie Mac were placed into conservatorship and were infused with tens of billions of dollars of taxpayer support. And if not for unprecedented actions by Congress, the Treasury, and the Federal Reserve, it is likely that many more failures would have occurred. Furthermore, the financial crisis was a global phenomenon that resulted in banking failures and financial panic throughout the world.

With the benefit of hindsight, there are many things Washington Mutual and the financial services industry could have done to better prepare for the worst economic downturn since the Great Depression. Washington Mutual aggressively reduced lending, raised new capital and cut operating expenses. But had we known that housing price declines of 40% or more would occur in the Company's key markets, we would have taken even more draconian measures.

And for the industry, I would have pushed even harder for higher and consistent capital requirements for all financial services firms, for strong regulatory oversight of all mortgage originators, for financial reporting that allowed the building of loan loss reserves during boom periods, and for enhanced consumer protection. I had spoken about all of these items on various occasions.

Recommendations

As Congress and the Regulators consider measures to strengthen the financial services industry and reduce the likelihood of another future financial crisis, I have six recommendations:

First, I have always supported strong regulation that applies to all participants in residential lending. Since the majority of new mortgage loans are originated through mortgage brokers, they should be regulated. In addition to licensing, testing and oversight, I believe broker compensation should be clearly disclosed to consumers.

Second, consumer protection should be a priority. Product disclosures and consumer education should be enhanced and Regulators should assure simple and understandable information is communicated to borrowers.

Third, all banks should be required to maintain high levels of capital that are risk-based. Minimum capital levels should be established because risk models like Basel II do not always capture extreme risks. Given asset value fluctuations and market volatility in recent years, capital requirements should be higher than in the past. And to the extent possible, standards need to be consistent for banks on a global basis.

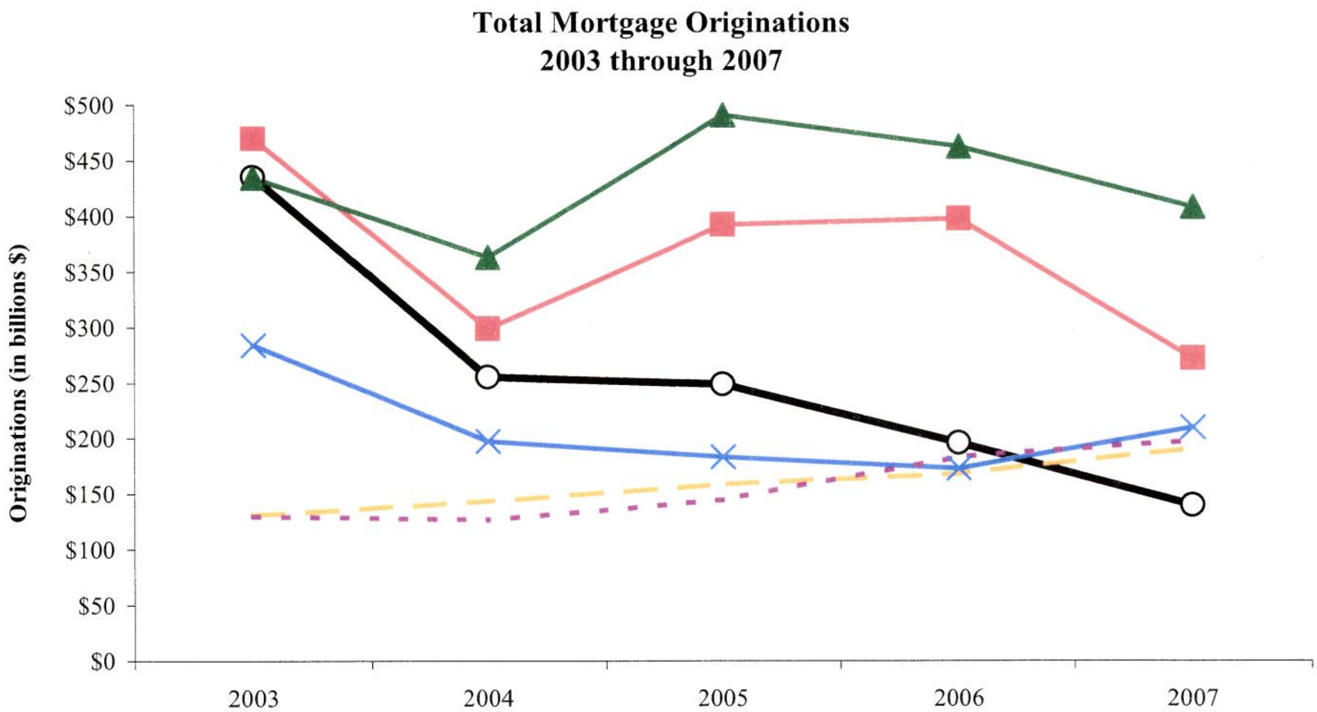
Fourth, accounting principles should be changed to permit the building of loan loss reserves during periods of economic prosperity.

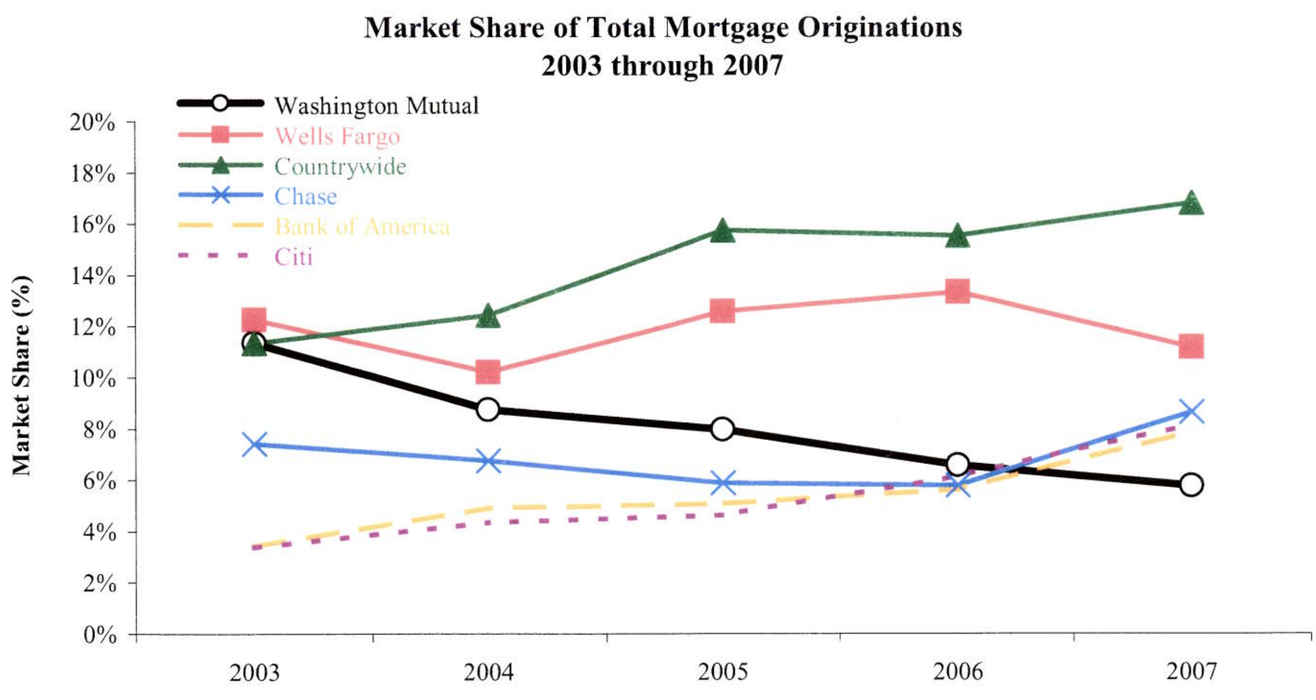
Fifth, regulators should monitor and control abusive short-selling of financial services stocks. Short sellers have the ability to do great damage by spreading unfounded rumors and causing panic, runs on deposits, and other liquidity events.

Sixth, regulatory oversight in the United States should be strengthened and simplified. Regulatory responsibilities should be clarified and in some cases consolidated. Regulatory actions should be fairly and equitably applied to all institutions.

Thank you for your time, and I hope this statement and my oral testimony will contribute to the Subcommittee's work.

Exhibit 1

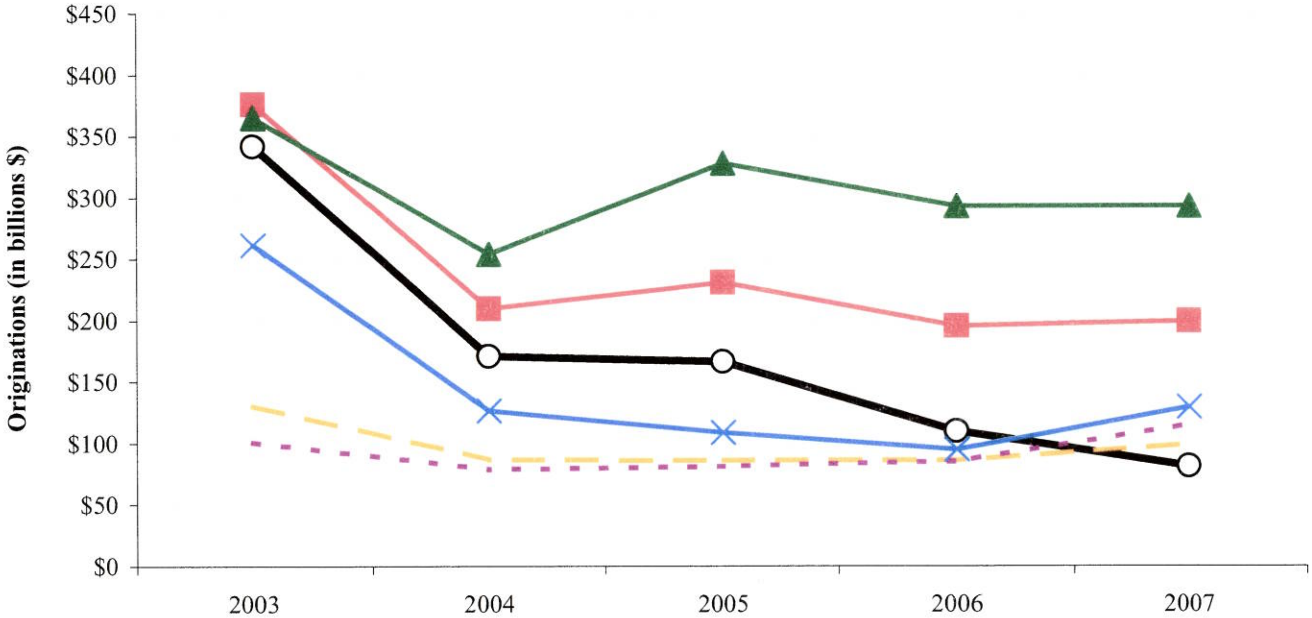




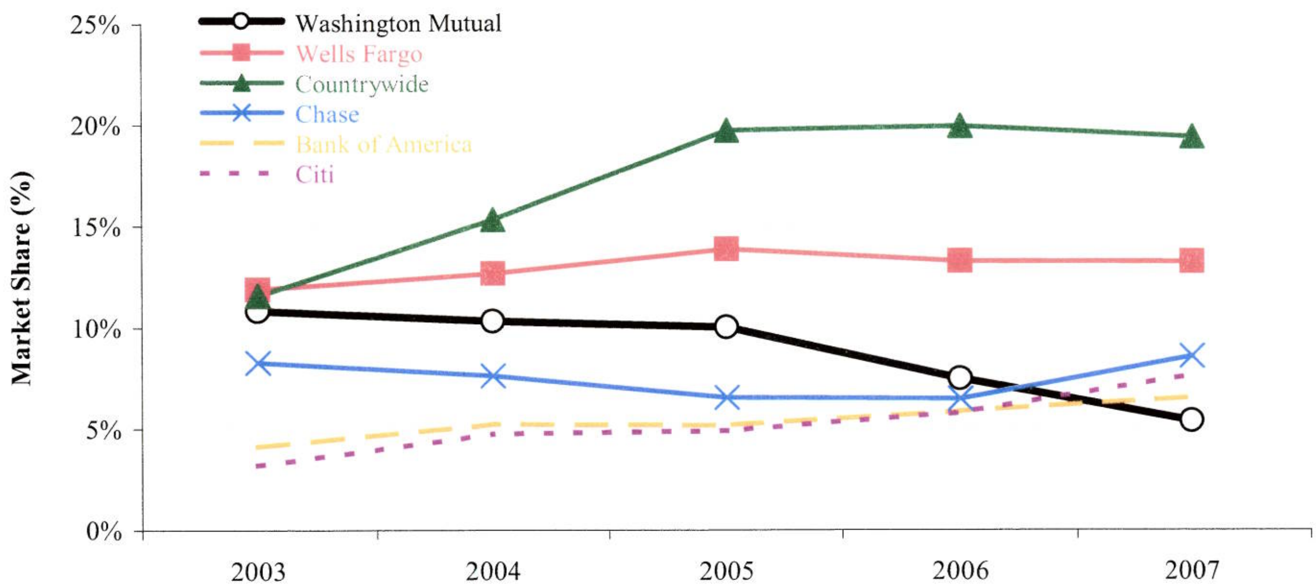
Notes and Sources: Data are obtained from Inside Mortgage Finance's ("IMF") *2009 Mortgage Market Statistical Annual Volume I*. According to the notes of IMF's "Top Mortgage Originators" tables, "[l]enders were asked to report 1-4 family residential mortgage originations. Wholesale purchases, including loans closed by correspondents, are counted. Lenders are instructed to include only HELOC amounts that are actually funded."

Exhibit 2

Conventional Mortgage Originations
2003 through 2007



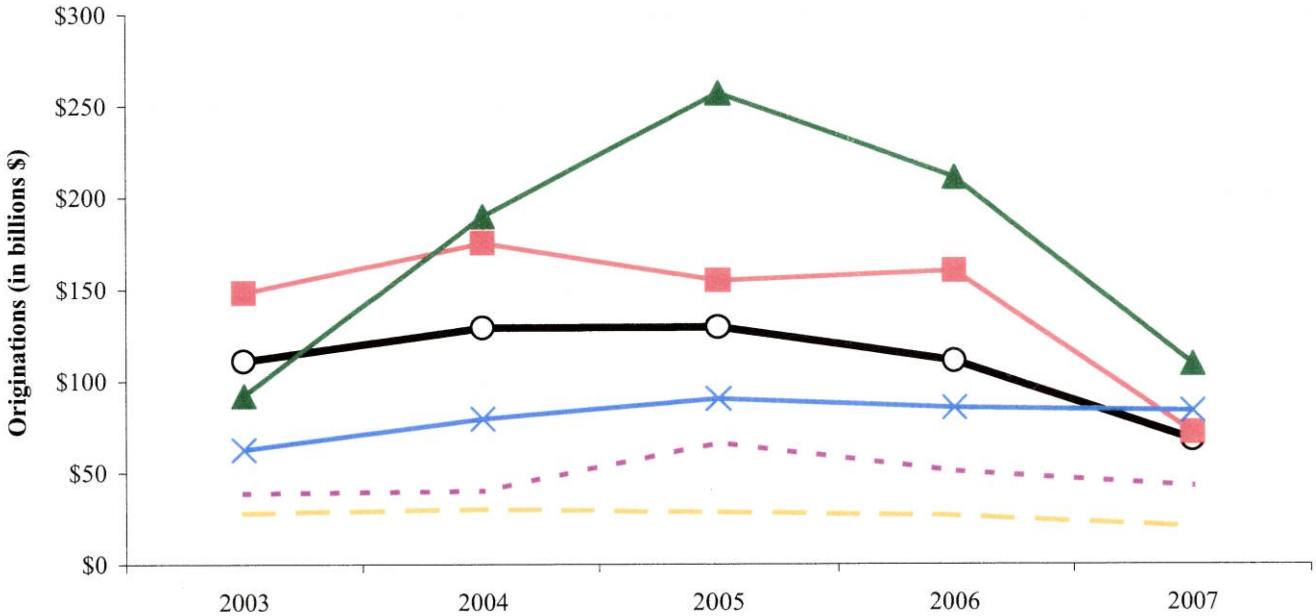
Market Share of Conventional Mortgage Originations
2003 through 2007



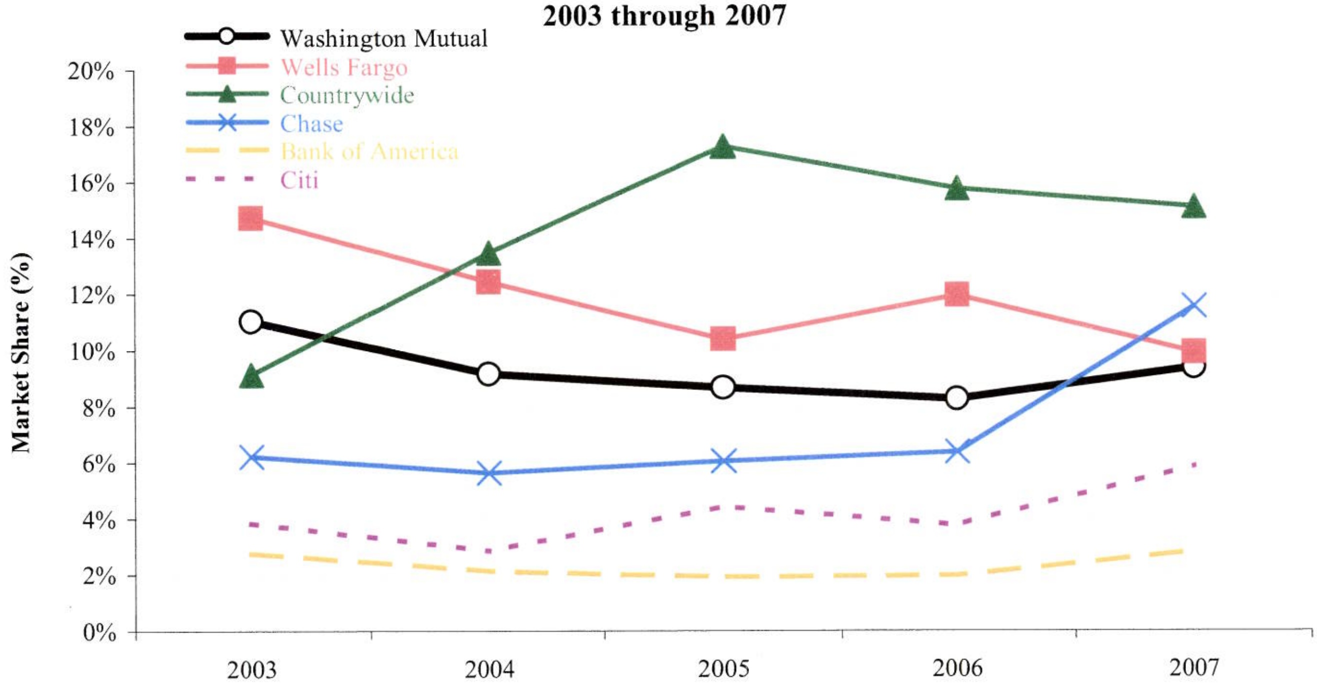
Notes and Sources: Data are obtained from Inside Mortgage Finance's ("IMF") *2009 Mortgage Market Statistical Annual Volume I*. We calculate conventional mortgage originations by adding conventional conforming mortgage originations and prime jumbo mortgage originations from the IMF tables "Top Conventional Conforming Producers" and "Top Prime Jumbo Producers," respectively. According to the notes of the tables, IMF derives its data from "a survey of 60 lenders..., the Inside Mortgage Finance MBS Database, company disclosures and other public documents."

Exhibit 3

Adjustable Rate Mortgage Originations
2003 through 2007

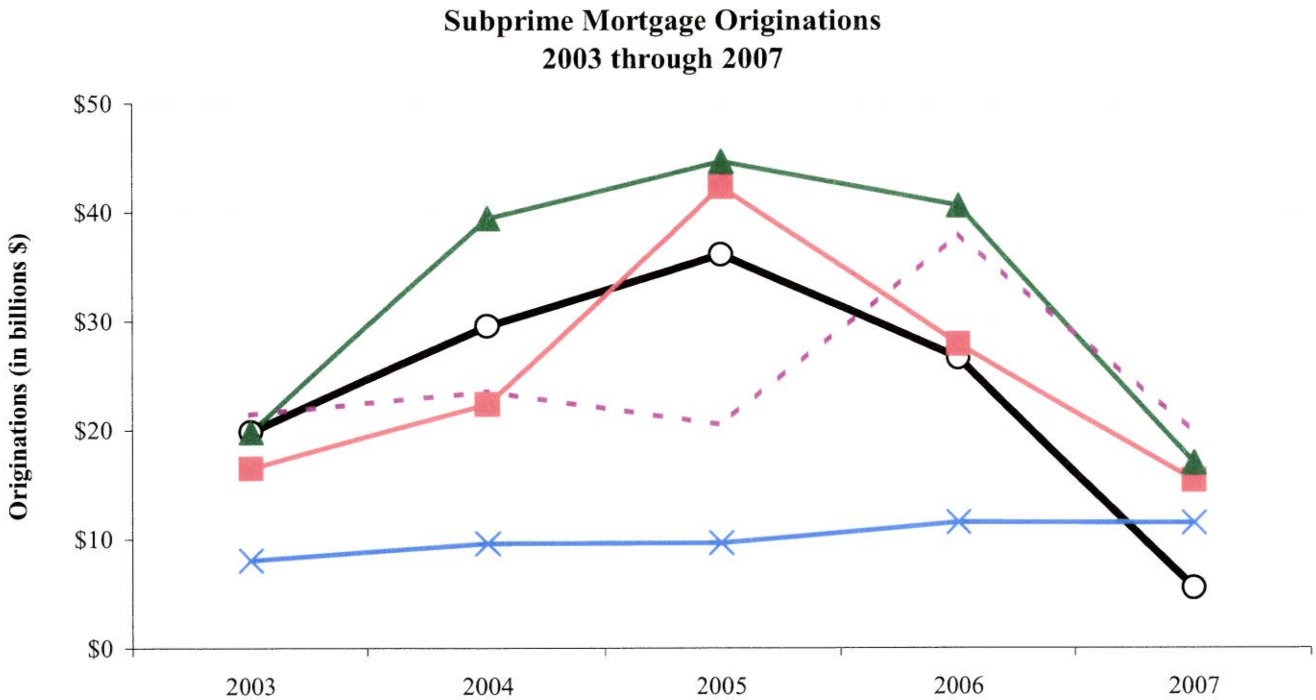


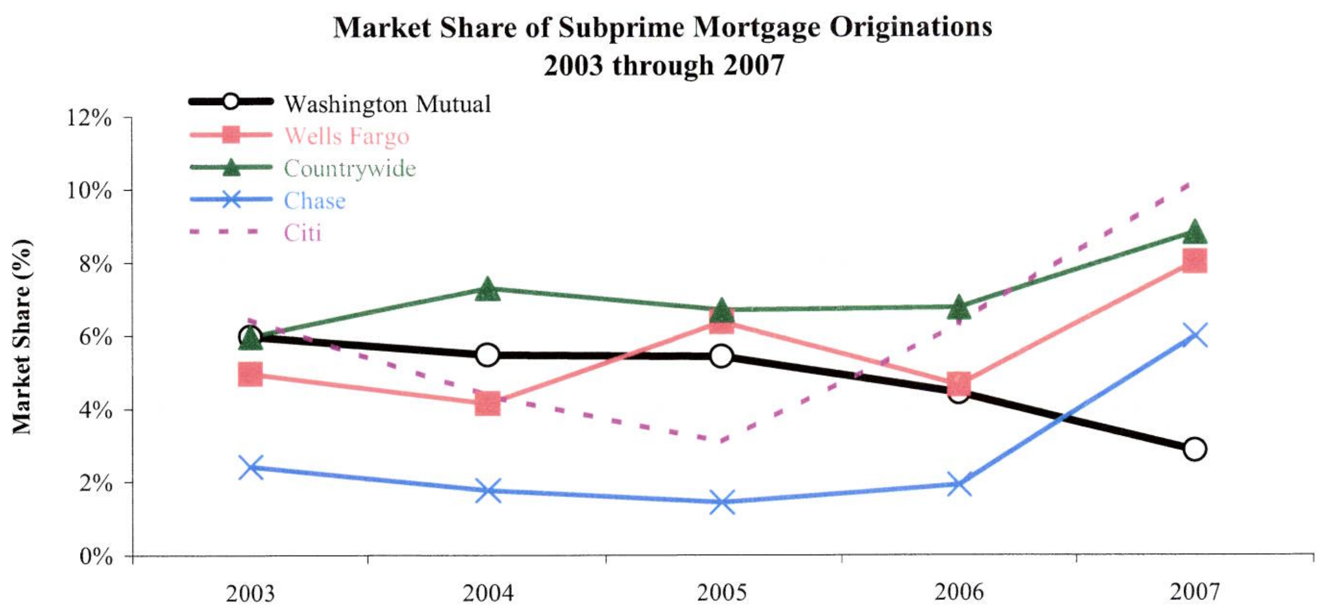
Market Share of Adjustable Rate Mortgage Originations
2003 through 2007



Notes and Sources: Data are obtained from Inside Mortgage Finance's ("IMF") *2009 Mortgage Market Statistical Annual Volume I*. According to the notes of IMF's "Top ARM Producers" tables, IMF derives its data from a "survey of 60 lenders..., the Inside Mortgage Finance MBS Database, company earnings and other public documents."

Exhibit 4





Notes and Sources: Data are obtained from Inside Mortgage Finance's ("IMF") *2009 Mortgage Market Statistical Annual Volume 1*. According to IMF's glossary, subprime loans are "loans made to those who have impaired credit. Generally have higher interest rates than prime loans. Such loans are tied to borrowers' credit ratings, expressed as letter grades, such as A-, B, D. Prime loans' credit is most often A." According to the notes of IMF's "Top Subprime Mortgage Lenders" tables, "B&C mortgages are defined as less than A quality, non-agency paper loans secured by real estate." Also according to the notes, "[l]enders were asked to report their origination volume... Wholesale purchases, including loans closed by correspondents, are counted." Subprime mortgage origination data for Bank of America are not available.

Exhibit 5

Since 1889, we have made it our business to responsibly provide for the credit and housing needs of our communities. In an increasingly complex financial world, Washington Mutual is committed to continuing its leadership role in addressing the credit needs of its communities, and setting the highest standards for responsible lending.

It is our fundamental belief that every creditworthy borrower should be able to get a loan. To that end, we are committed to providing services to consumers across a wide credit spectrum and with diverse borrowing needs. That is why in 2001, Washington Mutual established its Responsible Mortgage Lending Principles, becoming one of the first lenders to create specific principles to guide its mortgage lending activity. With our expansion into credit card lending, Washington Mutual is restating its Responsible Lending Principles to include credit card practices.

The Executive Committee of the Company will manage the Responsible Lending Principles in a manner consistent with these fundamental beliefs and ensure that the Principles are implemented, interpreted, and adjusted to meet changing business and community needs.

Washington Mutual Responsible Residential Mortgage Lending Principles

- We provide a range of residential mortgage products with varied features and benefits through our prime and non-prime channels, using risk-based underwriting guidelines that fairly price our products relative to the risks presented by our borrowers. While loan pricing may vary from borrower to borrower, it will do so based on their credit profiles. Differential pricing may also occur between our distributions channels, reflecting our variable cost of originating those loans. We will provide our borrowers with information that will allow them to choose the best product and pricing to meet their individual needs.
- We only extend credit to borrowers who have demonstrated to us the ability to repay the loan.
- We provide an option between loans with prepayment fees and lower pricing, and loans with higher pricing but without prepayment fees. If the prepayment fee option is chosen, we will not charge a prepayment fee following the third year after the loan is originated. For subprime adjustable rate mortgages with one or two year initial fixed rate terms, the prepayment

Exhibit 5

fee period will not exceed the fixed rate term of the loan, unless the borrower selects the longer prepayment period and receives lower pricing. We will not charge a prepayment fee when a debt is accelerated due to a borrower's default.

- We provide regular reporting of our borrower's entire loan account payment history to the major credit bureaus.
- We strive to offer an industry leading financial education program and will work with our non-profit partners to educate consumers so that they are better prepared to evaluate the range of loan products that can best suit their borrowing needs.
- We only do business with mortgage brokers that are in good standing with appropriate licensing authorities. When a broker presents a loan package to us, we independently evaluate the borrower's ability to repay the loan, as well as the proposed pricing and credit grade offered by the broker.
- We only do business with appraisal providers that are in good standing with appropriate licensing authorities.
- We offer 24-hour customer service through a combination of websites and nationwide toll-free numbers to make customer service more convenient for all our customers.
- We only use foreclosure as a remedy of last resort. To minimize the need for foreclosure, we employ a dedicated servicing team that offers workout and deferral opportunities to borrowers facing financial hardship so that they can avoid losing their homes. Additionally, we administer a $10 million Medical and Financial Hardship Fund to help borrowers avoid losing their homes as the result of unforeseeable hardships. Proceeds from the Fund will be used to establish revolving loan funds with non-profit organizations which have experience and expertise in foreclosure prevention programs.
- We do not refinance any loan secured by the borrower's home unless the new loan offers a net tangible benefit to the borrower.
- We do not originate loans where origination points (excluding discounts paid for a reduction in interest rate), yield spread premiums and non-pass-through fees combined exceed five percent of the loan amount.
- We do not purchase loans where origination points (excluding discounts paid for a reduction in interest rate), yield spread premiums and non-pass-through fees combined exceed five percent of the loan amount (except from time to time when purchasing loan pools, loans with fees in excess of 5% may be included).
- We do not originate or purchase non-prime loans with non-default call provisions, balloon payments due in less than ten years, or that negatively amortize (except for specialty products that allow limited interest deferrals at the borrower's option).
- We do not originate or purchase high-cost mortgage loans (as defined by HOEPA).
- We do not sell single premium credit insurance.

Exhibit 5

Washington Mutual Responsible Credit Card Lending Principles

- We promote our credit card products with a commitment to clarity. We clearly disclose our product terms, costs and conditions including any material limitations.
- We do not knowingly solicit business from, nor grant credit to individuals under the age of 18.
- We only extend credit to borrowers who have demonstrated to us the ability to repay the loan.
- We extend an appropriate amount of credit at an appropriate price consistent with our assessment of a consumer's available credit history, including, but not limited to, their external and internal credit scores, debt-to-income ratio and performance with us.
- We provide regular reporting of our consumer borrowers' loan account payment history, line and balance to the major credit bureaus.
- We do not increase interest rates on our loans solely on the basis of a single lenders' reporting of delinquent payment behavior to the major credit bureaus. Accountholder default and changes to consumer credit scores are the primary basis for account repricing.
- Our minimum payments are set to assure that borrowers who make payments on time always pay down their balance.
- We offer our borrowers a variety of options to make their payments via the mail, the phone or online. Borrowers may make their payment free via automated phone or online up to the day before their due date.
- We maintain an array of programs to assist our distressed borrowers who are not able to support monthly minimum payments.
- We accept debt management plans from qualified non-profit credit counseling agencies who work with our borrowers, and we reward agencies with incentive based performance contributions.
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