

On September 25, 2008, OTS placed Washington Mutual Bank into receivership, and the FDIC facilitated its immediate sale to JPMorgan Chase for \$1.9 billion. The sale eliminated the need to draw upon the federal Deposit Insurance Fund.

Findings. Washington Mutual was not the only mortgage lender to fail during the financial crisis. Nor was its high risk lending practices unusual. To the contrary, the Subcommittee investigation indicates that Washington Mutual was emblematic of practices at a number of financial institutions that originated, sold, and securitized high risk home loans from 2004 to 2008. Based upon the Subcommittee's investigation to date, we make the following findings of fact related to Washington Mutual Bank and its parent holding company, Washington Mutual Inc.

- (1) **High Risk Lending Strategy.** Washington Mutual ("WaMu") executives embarked upon a high risk lending strategy and increased sales of high risk home loans to Wall Street, because they projected that high risk home loans, which generally charged higher rates of interest, would be more profitable for the bank than low risk home loans.
- (2) **Shoddy Lending Practices.** WaMu and its affiliate, Long Beach Mortgage Company ("Long Beach"), used shoddy lending practices riddled with credit, compliance, and operational deficiencies to make tens of thousands of high risk home loans that too often contained excessive risk, fraudulent information, or errors.
- (3) **Steering Borrowers to High Risk Loans.** WaMu and Long Beach too often steered borrowers into home loans they could not afford, allowing and encouraging them to make low initial payments that would be followed by much higher payments, and presumed that rising home prices would enable those borrowers to refinance their loans or sell their homes before the payments shot up.
- (4) **Polluting the Financial System.** WaMu and Long Beach securitized over \$77 billion in subprime home loans and billions more in other high risk home loans, used Wall Street firms to sell the securities to investors worldwide, and polluted the financial system with mortgage backed securities which later incurred high rates of delinquency and loss.
- (5) **Securitizing Delinquency-Prone and Fraudulent Loans.** At times, WaMu selected and securitized loans that it had identified as likely to go delinquent, without disclosing its analysis to investors who bought the securities, and also securitized loans tainted by fraudulent information, without notifying purchasers of the fraud that was discovered.
- (6) **Destructive Compensation.** WaMu's compensation system rewarded loan officers and loan processors for originating large volumes of high risk loans, paid extra to loan officers who overcharged borrowers or added stiff prepayment penalties, and gave executives millions of dollars even when its high risk lending strategy placed the bank in financial jeopardy.

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Washington Mutual Practices That Created A Mortgage Time Bomb

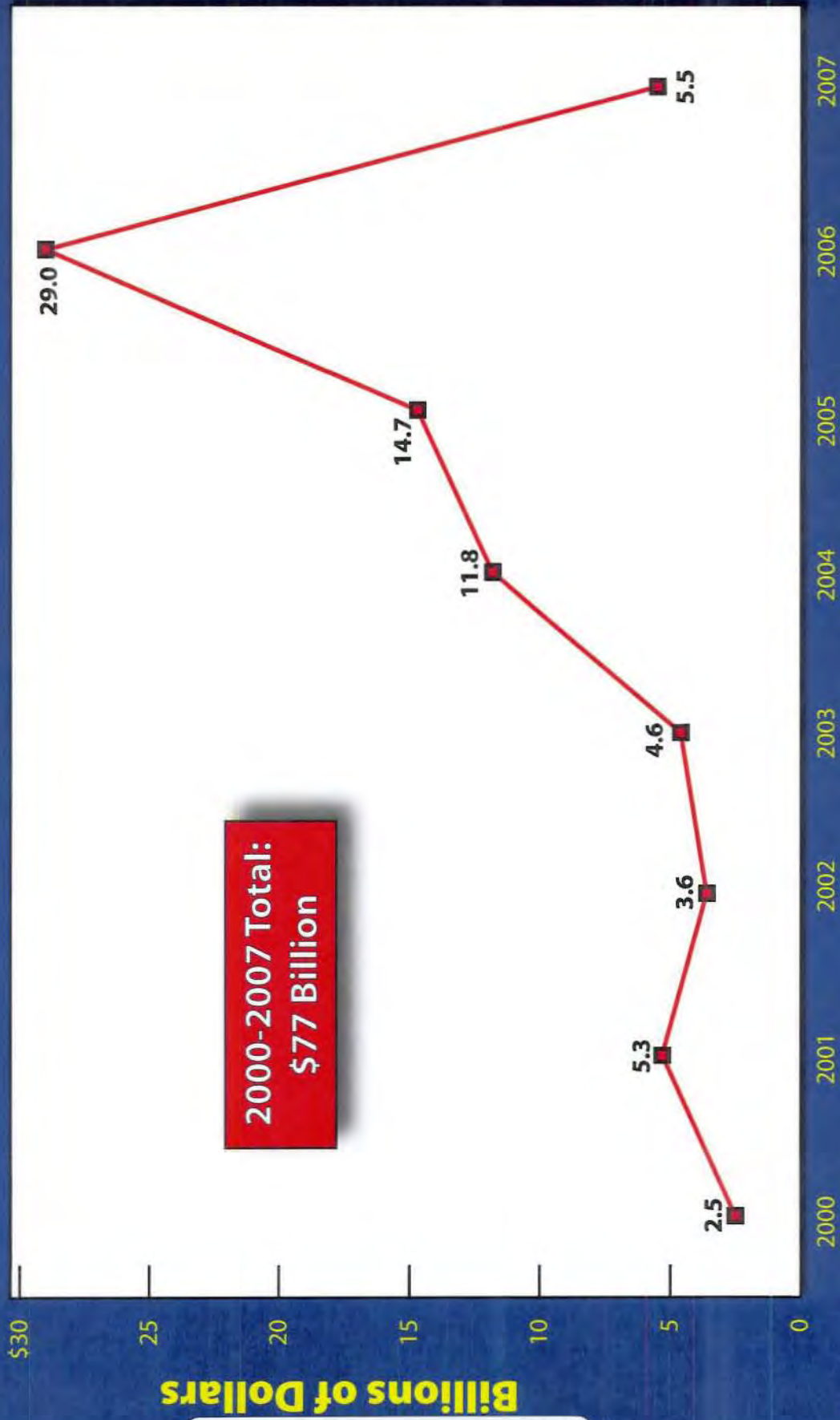
- Targeting Higher Risk Borrowers
- Steering Borrowers to Higher Risk Home Loans
- Increasing Sales of High Risk Home Loans to Wall Street
- Offering Teaser Rates
- Offering Interest Only and “Pick a Payment” Loans
- Offering Negative Amortizing Loans
- Not Verifying Income (Accepting Stated Income or “Liar” Loans)
- Requiring Low or No Documentation
- Qualifying Borrowers By Ability to Make Initial Low Payments
- Ignoring Signs of Fraudulent Borrower Information
- Presuming Rising Home Prices When Approving Loans
- Making Loans That Are Dependent on Refinancing to Work
- Using Lax Controls over Loan Approvals
- Offering Higher Pay for Making Higher Risk Home Loans
- Offering Higher Pay for Charging Excess Interest Rates or Points
- Rewarding Employees for Loan Volume over Loan Quality
- Securitizing Home Loans Identified as Likely to Fail
- Securitizing Home Loans Identified as Fraudulent

Prepared by U.S. Senate Permanent Subcommittee on Investigations, April 2010

Permanent Subcommittee on Investigations

EXHIBIT #1b

Securitizations of Washington Mutual and Long Beach Subprime Home Loans



**Excerpts from Documents Related to
Washington Mutual's Subprime Lender:
Long Beach Mortgage Corporation ("LBMC")
Lending and Securitization Deficiencies**

"An internal residential quality assurance (RQA) report for LBMC's first quarter 2003 ... concluded that 40% (109 of 271) of loans reviewed were considered unacceptable due to one or more critical errors. This raised concerns over LBMC's ability to meet the representations and warranty's made to facilitate sales of loan securitizations, and management halted securitization activity. A separate credit review report ... disclosed that LBMC's credit management and portfolio oversight practices were unsatisfactory. ... Approximately 4,000 of the 13,000 loans in the warehouse had been reviewed ... of these, approximately 950 were deemed saleable, 800 were deemed unsaleable, and the remainder contained deficiencies requiring remediation prior to sale. ... [O]f 4,500 securitized loans eligible for foreclosure, 10% could not be foreclosed due to documentation issues.

--FDIC-Washington State joint visitation report, 1/13/04, FDIC-EM_00102515, Exhibit 8(b)

"[Securitizations] prior to 2003 have horrible performance. LBMC finished in the top 12 worst annualized [net credit losses] in 1997 and 1999 thru 2003. ... At 2/05, LMBC was #1 with a 12% delinquency rate. Industry was around 8.25%."

--OTS email, 4/14/05, OTSWME05-0120000806, Exhibit 8(a)

"In 24 of 27 (88%) of the refinance transactions reviewed, policies established to preclude origination of loans providing no net tangible benefit to the borrower were not followed."

--WaMu audit of Long Beach, 9/21/2005, JPM_WM04656627

"LBMC experienced a dramatic increase in [Early Payment Defaults] during the third quarter of 2005. ... [R]elaxed credit guidelines, breakdowns in manual underwriting processes, and inexperienced subprime personnel ... coupled with a push to increase loan volume and the lack of an automated fraud monitoring tool, exacerbated the deterioration in loan quality."

--Wamu audit of Long Beach, 4/17/06, JPM_WM02533760-61, Exhibit 10

"[D]elinquencies are up 140% and foreclosures close to 70%. ... It is ugly."

--Steve Rotella email, 4/27/06, JPM_WM05380911, Exhibit 11

"LBMC is terrible.... Repurchases, [Early Payment Defaults], manual underwriting, very weak servicing/collections practices and a weak staff."

--Steve Rotella email, 9/14/06, JPM_WM00810317, Exhibit 12

"LBMC paper is among the worst performing paper in the mkt [sic] in 2006."

--David Beck email, 11/7/06, JPM_WM03871491, Exhibit 50

“Short story is this is not good. ... [L]arge potential risk from what appears to be a recent increase in repurchase requests. ... We are all rapidly losing credibility as a management team.”
 --David Schneider email, 12/22/06, JPM_WM03100333, Exhibit 13(a)

“Long Beach represents a real problem for WaMu. ... Appraisal deficiencies ... Material misrepresentations ... Legal documents were missing or contained errors or discrepancies ... Credit evaluation or loan decision errors ... [D]eterioration was accelerating in recent vintages with each vintage since 2002 having performed worse than the prior vintage.”
 --Ron Cathcart and Cynthia Abercrombie emails, Jan. 2007 & Dec. 2006, JPM_WM025556, Exhibit 16

“Washington Mutual Inc.’s subprime bonds are suffering from some of the worst rates of delinquency among securities in benchmark indexes, according to JPMorgan Chase & Co. research. ... Delinquencies of 60 days or more on loans supporting WaMu’s Long Beach LBMLT 2006-1 issue jumped ... to 19.44 percent ... the highest among the 20 bonds in the widely watched ABX-HE 06-2 index of bonds backed by residential loans to risky borrowers.”
 --“WaMu subprime ABS delinquencies top ABX components,” Reuters, 3/27/07, Exhibit 52

“[T]he overall system of risk management and internal controls has deficiencies related to multiple critical origination and underwriting processes These deficiencies require immediate effective corrective action to limit continued exposure to losses.”
 --Wamu audit of Long Beach, 8/20/07, JPM_WM02548940, Exhibit 19

“This [2007 audit report of Long Beach] seems to me to be the ultimate in bayonetting the wounded, if not the dead.”
 --Steve Rotella email, 8/21/07, JPM_WM04859837, Exhibit 20

“132 of the 187 (71%) files were reviewed ... confirmed fraud on 115 [and 17 were] ... ‘highly suspect’. ... 80 of the 112 (71%) stated income loans were identified for lack of reasonableness of income[.] 133 (71%) had credit evaluation or loan decision errors 58 (31%) had appraisal discrepancies or issues that raised concerns.”
 --Wamu Corporate Credit Review of Long Beach, 9/28/07, JPM_WM04013925, Exhibit 21

Excerpts from Documents Related to Washington Mutual's Prime Home Loan Lending and Securitization Deficiencies

“Craig [Chapman, Wamu executive,] has been going around the country visiting home lending and fulfillment offices. His view is that band-aids have been used to address past issues and that there is a fundamental absence of process.”

--OTS internal email, 8/13/04, Franklin_Benjamin-00003956_001

“[A]mong the referred cases there is an extremely high incidence of confirmed fraud (58% for [Downey office], 83% for [Montebello office]).”

--Wamu internal email, 8/30/05, JPM_WM04026075, Exhibit 23

“Fraud Loan Samples[:] Loan #0694256827 Misrepresentation [of] the borrower’s identification and qualifying information were confirmed in every aspect of this file, including: - Income – SSN – Assets – Alternative credit reference letters – Possible Strawbuyer or Fictitious borrower[.] The credit package was found to be completely fabricated. Throughout the process, red flags were over-looked, process requirements were waived, and exceptions to policy were granted.”

--Retail Fraud Risk Overview, 11/16/05, JPM_WM02481943, Exhibit 22(b)

“[A]n extensive level of loan fraud exists in the Emerging Markets [loan processing centers in southern California], virtually all of it stemming from employees in these areas circumventing bank policy surrounding loan verification and review. Of the 129 detailed loan review[s] ... conducted to date, 42% of the loans reviewed contained suspect activity or fraud, virtually all of it attributable to some sort of employee malfeasance or failure to execute company policy. ... Based on the consistent and pervasive pattern of activity amount these employees, we are recommending firm action be taken to address these particular willful behaviors on the part of the employees named.”

--Wamu So. CA Emerging Markets Targeted Loan Review Results, 11/17/2005, JPM_WM01083051, Exhibit 22(a)

“[D]elinquency behavior was flagged in October [2006] for further review and analysis The primary factors contributing to increased delinquency appear to be caused by process issues including the sale and securitization of delinquent loans, loans not underwritten to standards, lower credit quality loans and seller servicers reporting false delinquent payment status.”

--WaMu Market Risk Committee Minutes, 12/12/06, JPM_WM02095545, Exhibit 28

“Our appetite for credit risk was invigorated with the expansion of credit guidelines for various product segments including the 620 to 680 FICO, low doc loans, and also for home equity. ... In 2007, we must find new ways to grow our revenue. Home Loans Risk Management has an important role to play in that effort.”

--Home Loans Chief Risk Officer’s message to risk management team, 12/26/06, JPM_WM02555659, Exhibit 73

“I said the other day that HLs [Home Loans] (the original prime only) was the worst managed business I had seen in my career. (That is, until we got below the hood of Long [B]each.)”

--Steve Rotella email, 8/23/07, JPM_WM00675851, Exhibit 79

“One Sales Associate admitted that during that crunch time some of the Associates would ‘manufacture’ asset statements ... and submit them to the [loan processing center]. She said the pressure was tremendous ... since the loan had already [been] funded and pressure from the Loan Consultants to get the loans funded.”

--Significant Incident Notification re Westlake Village Home Loan Center, 4/1/08, JPM_WM05452386, Exhibit 30

“Risk Mitigation reviewed 25 HELOC [Home Equity Lines of Credit] loans originated between 2/6/08 and 4/19/08 ... with a total exposure of \$8,538,600.00. The review found that the borrowers indicated they owned the property free and clear when in fact existing liens were noted on the properties. The properties are located in California, Arizona and Washington. ... WaMu used ... Abbreviated Title reports [that] ... do not provide existing lien information on the subject property.”

--Significant Incident Notification re HELOC Fraud, 5/1/08, JPM_WM05452389, Exhibit 32(b)

“[A] third party mortgage insurer, notified WaMu of fraud concerns in June 2007. Resolution of this complaint was not completed WaMu Legal and [Home Loan] senior management had no method of knowing the existence of this complaint or its resolution status. ... [F]or the September and October 2007 sampled time period, the volume of misrepresentation and suspected loan fraud continued to be high for [Montebello, a southern California loan processing center](62% of the sampled loans). ... Loan Producers were compensated for volume of loans closed and Loan Processors were compensated for speed of loan closing rather than a more balanced scorecard of timeliness and loan quality. ... Risk Mitigation conducted loan reviews on loans produced from September 9, 2003 to August 8, 2005 and found excessive levels of fraud related to loan qualifying data particularly in the retail broker loans (78%). ... Outside of training sessions ... in late 2005, there was little evidence that any of the recommended strategies were followed or that recommendations were operationalized. There were no targeted reviews conducted ... on the Downey or Montebello loan portfolios between 2005 and the actions taken in December 2007.”

--WaMu internal memorandum, 4/4/08, pages 1-2, 6-7, 9, Exhibit 24

“The controls that are intended to prevent the sale of loans that have been confirmed ... to contain misrepresentations or fraud are not currently effective. There is not a systematic process to prevent a loan ... confirmed to contain suspicious activity from being sold to an investor. ... Of the 25 loans tested, 11 reflected a sale date after the completion of the investigation which confirmed fraud. There is evidence that this control weakness has existed for some time.”

--WaMu internal Corporate Credit Review, 9/8/08, JPM_WM00312502, Exhibit 35

Excerpts from Documents Related to Washington Mutual Compensation and Incentives

“To those of you who have not yet reached President’s Club, I want each and every one of you to believe you have the potential to achieve this great reward. Now is the time to really kick it into high gear and drive for attending this awesome event! Rankings are updated and posted monthly I’m especially pleased with your ability to change with the market and responsibly sell more higher-margin product – Option ARM, Home Equity, Non-prime, and Alt A.”

--WaMu internal document to Home Loans sales force, Nov. 2006, JPM_WM03077124, Exhibit 62

“Incentive Tiers reward high margin products ... such as the Option ARM, Non-Prime referrals and Home Equity Loans Wamu also provides a 15 bps ‘kicker’ for selling 3 year prepayment penalties.”

--WaMu Retail Loan Consultant 2007 Incentive Plan, undated, JPM_WM03097217, Exhibit 60(a)

“Overages ... [give a] Loan Consultant [the] [a]bility to increase compensation [and] [e]nhance compensation/incentive for Sales Management Major national competitors have a similar plan in place in the market. ”

--WaMu proposal, adopted in 2007, to pay overages – added compensation to loan officers who sell loans with a higher interest rate or points than required on WaMu’s daily rate sheet, undated, JPM_WM02583396, 98, Exhibit 60(b)

“[W]e have to convince our folks that they will all make a lot of money by being with WaMu.”

--Kerry Killinger email, 1/3/08, JPM_WM01335818, Exhibit 65

“The board of Washington Mutual Inc. has set compensation targets for top executives that will exclude some costs tied to mortgage losses and foreclosures when cash bonuses are calculated this year.”

--“WaMu Board Shields Executives’ Bonuses,” Wall Street Journal, 3/5/08, Exhibit 67

“Loan Producers were compensated for volume of loans closed and Loan Processors were compensated for speed of loan closing rather than a more balanced scorecard of timeliness and loan quality. ... A design weakness here is that the loan consultants are allowed to communicate minimal loan requirements and obtain various verification documents from the borrower that [are] need[ed] to prove income, employment and assets. Since the loan consultant is also more intimately familiar with our documentation requirements and approval criteria, the temptation to advise the borrower on means and methods to game the system may occur. Our compensation and reward structure is heavily tilted for these employees toward production of closed loans.”

--WaMu internal memorandum, 4/4/08, page 11, Exhibit 24

“[T]he review defines an origination culture focused more heavily on production volume rather than quality. An example of this was a finding that production personnel were allowed to participate in aspects of the income, employment, or asset verification process, a clear conflict of interest. ... Prior OTS examinations have raised similar issues including the need to implement incentive compensation programs to place greater emphasis on loan quality.”

--OTS Memo No. 22, Loan Fraud Investigation, 6/19/08, JPM_WM02448184, Exhibit 25

“Chief Risk Officer – Home Loans ... Employee Goals ... GROWTH 35% ... Achieve Net Income - \$340 MM for 2007 ... Subprime -\$32B ... Option ARM - \$33B ... RISK MANAGEMENT 25%”

--Performance Review Form for Chief Risk Officer, undated, JPM_WM01365325, Exhibit 64

“We would disclose the exclusion of [Executive Committee] members from the bonus plan. There would be no disclosure of the retention cash payments. Option grants would be held off until whenever other comp. actions were done.

--Kerry Killinger email, 7/16/08, JPM_WM01240144, Exhibit 66

“Creditors in Washington Mutual Inc.’s bankruptcy could go after a \$16.5 million cash severance payment promised to ousted CEO Kerry Killinger ... [and] a \$7.5 million signing bonus for his successor, Alan Fishman, who ran the bank for 18 days before it failed.”

--“WaMu creditors could challenge payments to Killinger, others,” Seattle Times, 10/1/08, Exhibit 68

SELECT DELINQUENCY AND LOSS DATA FOR WASHINGTON MUTUAL SECURITIZATIONS

AS OF FEBRUARY 2010

Securitization Series	Loan Type	Delinquent	Foreclosure	REO	Total Loan Delinquency Rate	Total Loss Since Issuance
LBMLT 2006-WL1	Subprime	38.09%	14.09%	4.47%	56.65%	18.97%
WAMU 2007-HE1	Subprime	37.39%	12.26%	5.30%	54.95%	19.77%
WAMU 2007-HE2	Subprime	12.88%	11.14%	6.14%	30.16%	18.48%
WAMU 2007-HE3	Subprime	42.17%	11.39%	3.85%	57.41%	14.95%
LBMLT 2006-A	Subprime/2nd Lien	39.64%	.17%	0%	39.81%	65.61%
WAMU 2007-OA6	Option ARM	19.32%	24.9%	4.37%	48.59%	5.85%
WMALT 2007-OA3	Option ARM	23.66%	25.45%	5.74%	54.85%	7.99%
WMALT 2007-OC1	Hybrid ARM	25.48%	31.64%	6.94%	64.06%	17.58%

Source: www.wamusecurities.com

Delinquent – Percentage of outstanding loans (by dollar amount) that have missed payments but are not yet in default

Foreclosure - Percentage of outstanding loans (by dollar amount) that are in foreclosure

REO – Percentage of outstanding loans (by dollar amount) that have completed foreclosure, resulting in bank-owned real estate

Total Loan Delinquency Rate – Total calculated by adding the Delinquent, Foreclosure and REO columns

Loss Since Issuance – Cumulative percentage loss relative to initial principal balance of the securities

Prepared by the U.S. Senate Permanent Subcommittee on Investigations, April 2010

**WASHINGTON MUTUAL CEO KERRY KILLINGER:
\$100 MILLION IN COMPENSATION, 2003-2008**

	Salary	Cash Bonus	Dollar Value of Stock Awards	Dollar Value of Stock Option Awards	Gain from Exercising Stock Options	Other**	401(k) Pension Benefits	SERP Pension Benefits	SERAP Pension Benefits	ETRIP Pension Benefits	Deferred Bonus Plan	Deferred Compensation Plan	Total Compensation +
2003	\$1 million	\$2.9 million	\$5.3 million	760,000 options: \$19-\$48 million value	108,000 stock options exercised: \$2.7 million value	\$76,000	\$11,200	\$333,241	\$481,079	Not in effect	Not reported	Not reported	\$11.9 million
2004	\$1 million	\$1.9 million	\$8.9 million	0	105,150 stock options exercised: \$3.4 million value	\$105,500	\$8,200	\$306,693	\$2.3 million lump sum value	\$854,000 lump sum value	\$260,978 in accrued benefits	\$14.6 million total value	\$15.3 million
2005	\$1 million	\$3.5 million	\$8.7 million	268,000 options: \$7-\$18 million value	168,000 stock options exercised: \$5.4 million value	\$119,000	\$8,400	\$222,573 (\$2.7 million lump sum value)	\$2.5 million lump sum value	\$2.1 million lump sum value	\$285,661 in accrued benefits	\$20.8 million total value	\$18.7 million
2006	\$1 million	\$4.1 million	\$8.7 million	458,900 options: \$3.9 million value	216,893 stock options exercised: \$7.2 million value	\$154,772	\$10,000	\$346,800 (\$3.1 million lump sum value)	\$2.6 million lump sum value	\$3.9 million lump sum value	\$336,304 in accrued benefits	\$22.6 million total value	\$21.1 million
2007	\$1 million	0	\$10.1 million	355,800 options: \$3.1 million value	0	0	\$9,000	\$387,920 (\$3.7 million lump sum value)	\$2.8 million lump sum value	\$4.1 million lump sum value	\$352,170 in accrued benefits	\$8 million total value	\$11.1 million
2008	\$686,000	0	\$1.7 million	3.2 million options expiring in 2015: no value given	Stock option deferred gain: \$365,000 value	\$15.3 million; \$445,200; \$300,669	\$148,000	\$3.8 million lump sum payment	\$2.9 million lump sum value	Not reported	Not reported	\$2.6 million distribution	\$25.1 million

Grand Total: \$103.2 million

Source: Washington Mutual Proxy Statements, Schedule 14A, 2004-2008; 2008 compensation data from Washington Mutual Inc., which Mr. Killinger left in Sept. 2008.

Dollar value of stock awards, stock option awards, stock option gains, pension benefits, and deferred compensation taken from proxy statements.

** Amounts taken from proxy statements, and include compensation for financial and tax planning, car and parking expenses, corporate jet travel, tax gross-up expenses.

In 2008, includes \$15.3 million severance payment; \$445,200 lump sum payment for vacation benefits; and \$300,669 "special payment."

+ Totals include salary, bonus, stock awards value, stock option gains, other compensation. In 2008, also includes SERP and deferred compensation distributions.

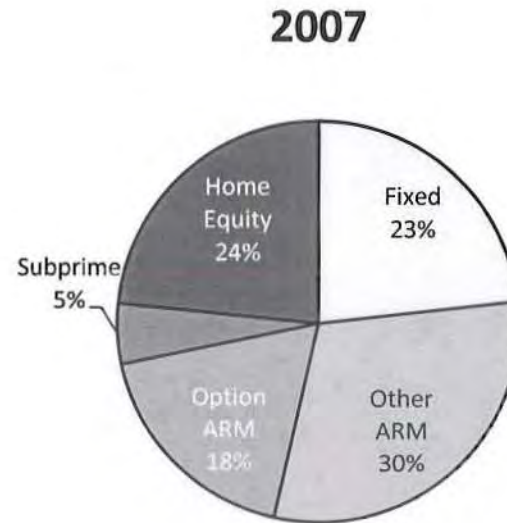
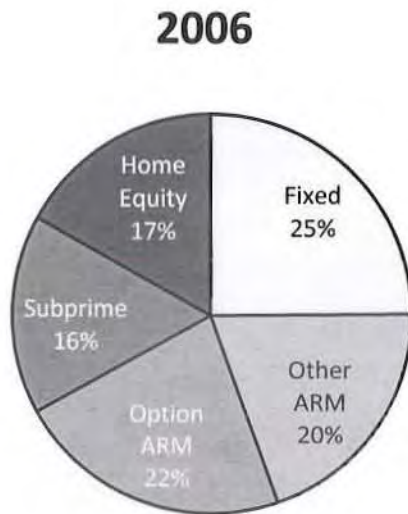
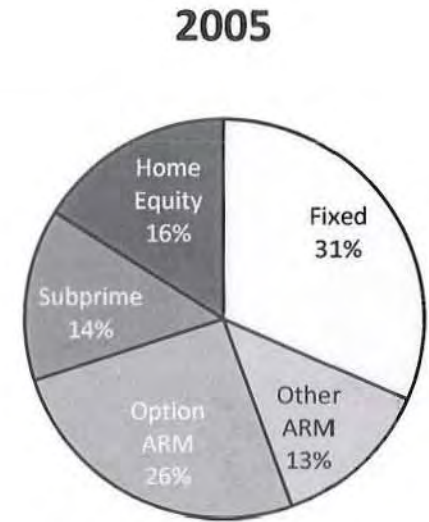
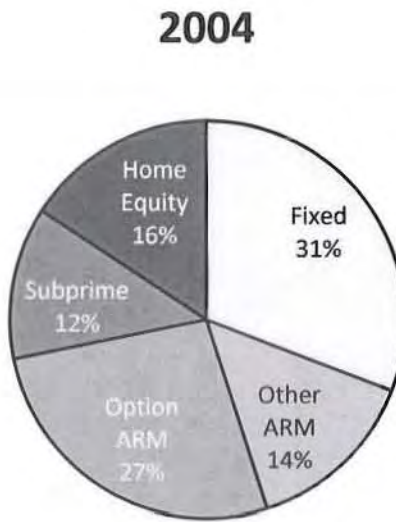
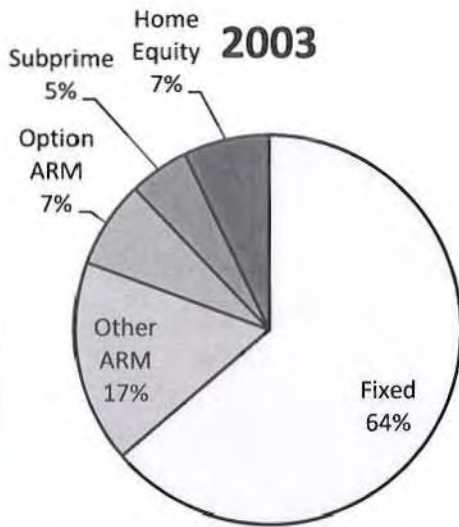
Totals do not include value of stock option awards, pension benefits, or deferred compensation or deferred bonus plans.

SERP: Supplemental Executive Retirement Plan; SERAP: Supplemental Executive Retirement Accumulation Plan; ETRIP: Executive Target Retirement Income Plan.

Prepared by U.S. Senate Permanent Subcommittee on Investigations, April 2010

WAMU PRODUCT ORIGINATIONS AND PURCHASES BY PERCENTAGE - 2003-2007

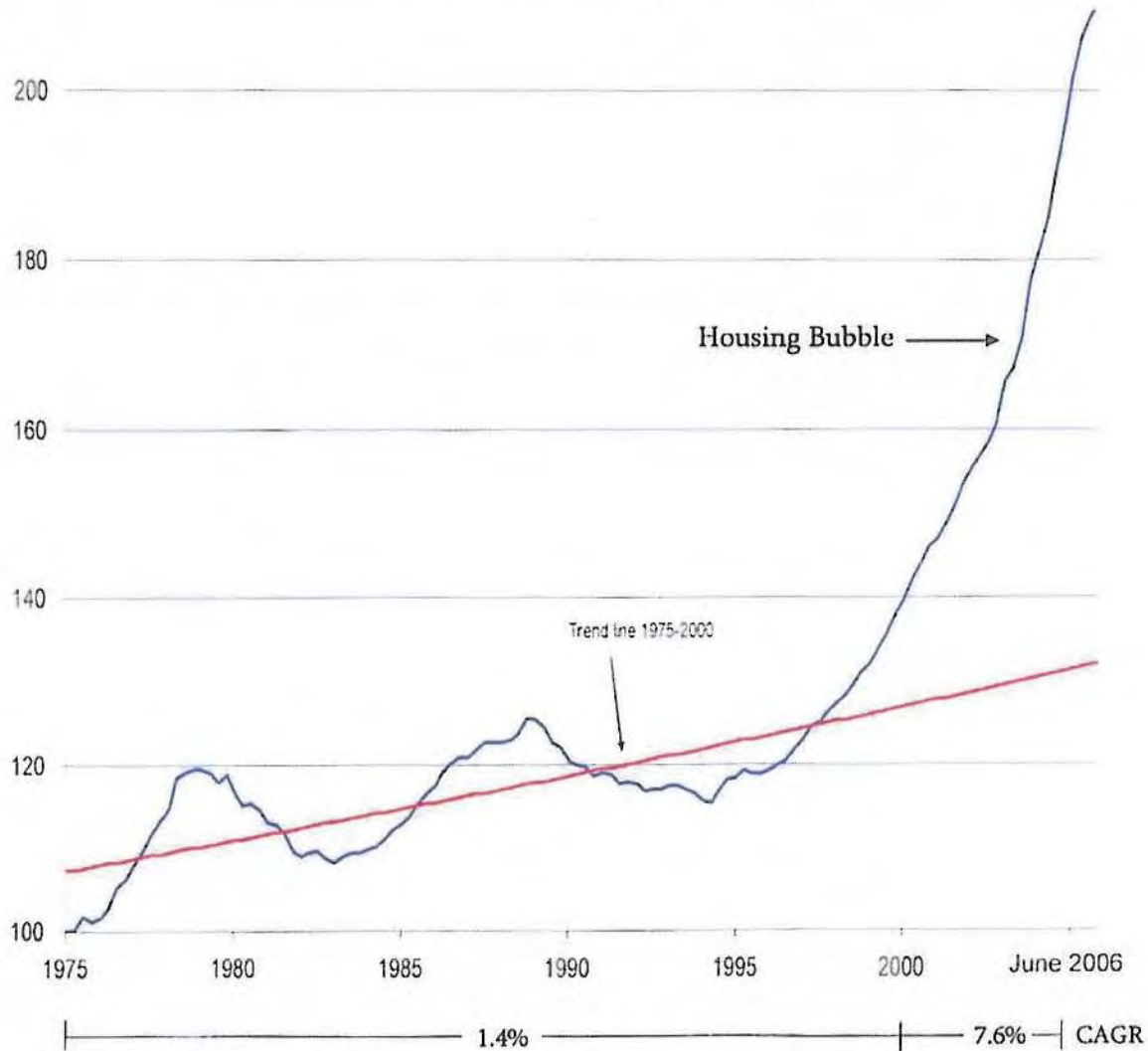
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Source: Washington Mutual Inc. SEC Filings, 2003-2007. Prepared by the U.S. Senate Permanent Subcommittee on Investigations, April 2010

ESTIMATION OF HOUSING BUBBLE: Comparison of Recent Appreciation vs. Historical Trends

Real Home Price Index (1975 = 100)



Permanent Subcommittee on Investigations
EXHIBIT #11

Source: Office of Federal Housing Enterprise Oversight, Bureau of Economic Analysis

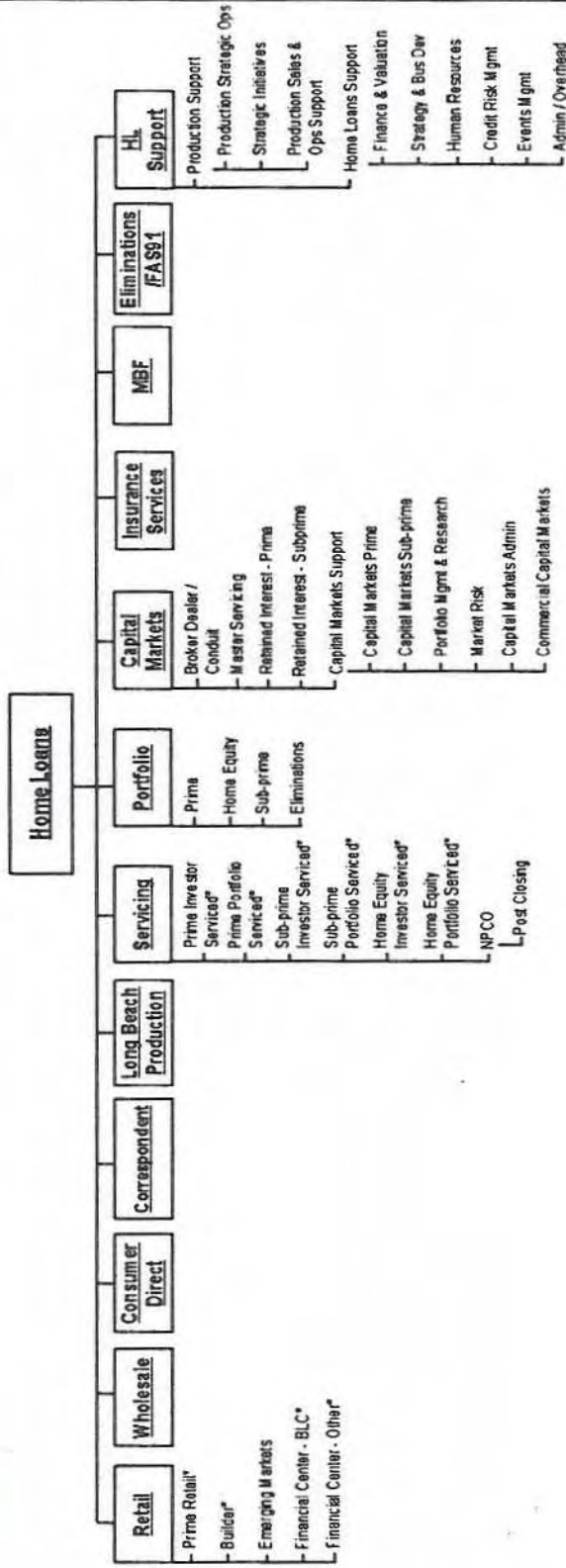
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Org Profitability: Future State Hierarchy



* Likely not completed until Phase II
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