Washington Mutual: The Largest Bank Failure in U.S. History

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ABSTRACT

Bank failures occur for reasons that are distinct from the failure of other types of firms. This case presents the failure of Washington Mutual (WaMu). In this case, students will examine how failures in asset management, liability management, credit risk management, and liquidity management can lead to a bank's downfall. In addition, the case will provide insight into the effects of a financial crisis on a financial institution like WaMu.

The beginning of the case explains different aspects of bank management in case students are not familiar with these concepts or to allow concepts learned in class to be reinforced. The appendices to the case showcase articles published throughout the process of WaMu failing. These articles paint a vivid, dramatic picture of the events and the fact that this is not fictitious helps to drive the point of the case home. The questions presented on the case lead the student through the process of discovering the major reasons why the bank failed, and it gets them to see how markets converged on WaMu to cause this failure.

Keywords: Bank Failure, Bank Management, Liquidity Management, Washington Mutal, Financial Crisis.

INTRODUCTION

In May of 1984, Continental Illinois National Bank and Trust Company failed. It was the largest bank failure in U.S. history at the time and began the "Too-Big-To-Fail" (TBTF) era. TBTF is the notion that a bank is too systematically important to let fail, and that the institution must be saved or the disruption to the financial system would be too great. Continental Illinois failed for two reasons. One, it had taken on great risk in its lending which led to a high level of nonperforming loans. Writing down these loans decreased the equity capital the bank possessed and increased the likelihood of insolvency. Second, Continental Illinois relied on liquid funding. Of its $28.2 billion in deposits, $20.7 billion of those deposits were over the $100,000 (at the time) insurance limit set by the FDIC. Thus, if the bank failed, those depositors should lose their money. Thus, when the bank appeared to be in trouble, there was a "run" on the bank and Continental Illinois lost its funding. To prevent the bank from failing, the FDIC took unprecedented steps and protected all bondholders and depositors. While equity holders were wiped out, the bank was saved and remained under government control until 1991. It was later sold to Bank of America in 1994.[1,2]

Fast forward to 24 years later. It is 2008 and the financial crisis is taking its toll but has not peaked yet. Washington Mutual (WaMu, for short) is in a similar situation. Whereas Continental Illinois had heavy losses in commercial and industrial loans in 1984, ike many banks, WaMu had steep losses in mortgages and in mortgage-backed debt. As reported on September 16, 2008, in *The Washington Post*:

> "Washington Mutual is in trouble primarily because of its role in selling option ARMs, mortgage loans with payment terms that resemble a credit card, allowing the borrower to pay less than the total due each month. The default rates on such loans more closely resemble the high failure rates on credit cards than the low failure rates on conventional mortgage loans."[3]

In the spring of 2008, WaMu reported more than $3 million in home mortgage write-downs and loan losses. On March 14, 2008, Moody's Investors Service downgraded WaMu's debt rating to one step above junk bond status. This precipitated a 13% decline in WaMu's share price by the following Monday, March 17th.[4]

What was happening to WaMu? Why were shareholders and creditors concerned? To discover the reason, we need to be familiar with three different areas of bank management and the concept of agency theory.

AGENCY THEORY AND BANKING

Deposit insurance is an important piece of the government safety net for banks and is a major reason for the virtual nonexistence of bank runs since the Great Depression when FDIC was created in 1933. Another piece, although implied instead of explicit, is the TBTF policy surrounding large institutions. Both give depositors and other creditors assurance they will be

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[1] Federal Reserve History. "Failure of Continental Illinois." federalreservehistory.org. November 22, 2013.

[2] History of the Eighties: Lessons for the Future, an Examination of the Banking Crises of the 1980s and Early 1990s. United States: Federal Deposit Insurance Corporation, 1997.

[3] See Appendix 7

[4] See Appendix 2

protected in case of a bank failure. The positive side to this is that runs on banks (including healthy ones) will not occur causing bank failure and negative impacts on the financial system.

On the other hand, what sort of incentive does the safety net create for bank owners, managers, and creditors (including depositors)? Safety nets such as this act as insurance against failure, creating a moral hazard problem. Specifically, if depositors know their losses will be prevented, they have less incentive to monitor the bank managers' decisions regarding risk. Managers are rewarded for generating higher returns. But higher expected returns typically involve more risk. So, if this safety net makes creditors feel less vulnerable, they will not monitor management appropriately. Therefore, banks will engage in riskier behavior in the presence of this kind of safety net.

ASSET MANAGEMENT

Like any investor, a bank's objective is to generate the highest return with the lowest amount of risk. Another part of a bank's asset management strategy, however, is to maintain an appropriate amount of liquidity. Unlike most businesses, banks face withdrawals from their depositors. Since highly liquid assets (like reserves and currency) have low returns, keeping a minimum of liquid assets is preferred in order to maximize the bank's overall return on its portfolio of assets.

Like any portfolio, the risk return combination of the bank's portfolio benefits from diversification. In this case, diversification among borrowers, lending in different geographic regions, and making different types of loans across industries helps diversify the bank. In making loans, banks also screen their borrowers to allocate loans to different risk types. Banks then charge appropriate rates based on the riskiness of each loan. In some cases, when the risk is too great, they may refuse to lend to a borrower. This is referred to as credit rationing.

LIABILITY MANAGEMENT

On the other side of the balance sheet, liabilities for the banking industry have changed over time. Up until the 1970s, banks largely relied on bank deposits to get funding for their lending activities. These funds paid little or no interest and, thus, were inexpensive and provided a stable source of funding. However, as other products entered the market, such as money market mutual funds, where people and businesses could earn higher rates of interest, banks expanded their liabilities to compete with these new products. This allowed banks to borrow from public markets in order to finance their lending and quickly take advantage of new opportunities as they arose. On the other hand, these funds were more expensive and subject to "availability" risk. Since these funds are not covered by the FDIC, they could dry up if the bank ran into trouble, or even if depositors perceive that the bank is in trouble. If this does occur, the bank may have to liquidate assets, possibly even long-term assets.

LIQUIDITY MANAGEMENT AND RISK

Managing liquidity risk requires a combination of asset and liability management. Since banks face withdrawals, they need to maintain liquidity to meet their cash needs. One way to minimize liquidity risk is to hold higher balances of cash and reserves. However, since these assets earn low returns, holding too many liquid assets hurts the profitability of the bank.

Another way to meet liquidity targets is to raise funds in short-term public markets, such as negotiable certificates of deposit, repurchase agreements, or the fed funds market. The downside to this is the interest cost of the funds and the "availability" risk described above. Overall, there are safe ways to maintain liquidity that come with lower returns and riskier ways to maintain liquidity that promise higher returns.

A TIMELINE FOR WAMU

Spring of 2008

As the financial crisis unfolded in March of 2008, concern surrounding WaMu's loan portfolio began to build as WaMu reported more than $3 million in home mortgage write-downs and loan losses. As noted in an article by Valerie Bauerlein in *The Wall Street Journal* on March 18th, "Washington Mutual shares dropped 13%, or $1.35, to $9.24 on the NYSE, after Moody's Investors Service cut the company's debt rating Friday to one step above junk status" and "Analyst David Hilder of Bear Stearns cites banks with big real- estate exposure relative to their asset size. WaMu has 71% of its loans in real estate, compared to 51% for National City and 47% for Huntington Bancshares Inc. of Columbus, Ohio." Given that the nexus of the crisis surrounded real estate, and the fact that a sizeable percentage of WaMu's portfolio consisted of riskier borrowers with adjustable-rate mortgages, WaMu's future looked more uncertain than that of other financial institutions.

The financial news at the time points to drastic changes in WaMu's financial condition around the same time. The April 8th edition of *The International Herald Tribune* announced that,

> "Washington Mutual lost $1.87 billion in the fourth quarter of 2007, hurt by exposure to housing markets like California and Florida. Analysts expect more losses at least through 2008, and several have said Washington Mutual has not set aside enough to cover bad loans. While Washington Mutual has pared its exposure to subprime and other riskier home loans, it did not do so fast enough, and losses soared as credit markets shut down." To help offset some of those losses and hits to its capital, WaMu raised capital from TPG, a private equity firm. As discussed on the same The International Herald Tribune article, "Washington Mutual, the largest U.S. savings and loan, rallied in New York trading Monday on reports that a group led by the private equity firm TPG was considering a $5 billion investment in the Seattle-based institution."

Despite the injection of capital by TPG, on April 9th, Mark DeCambre of *The New York Post* wrote,

> "The Seattle-based bank saw its stock drop about 10 percent in trading yesterday after the firm formally announced a $7 billion cash infusion, which includes a $2 billion investment from TPG…. Positive sentiment had buffeted the bank's depressed shares by nearly 30 percent on Monday when word of the deal began to emerge. However, the overriding outlook on the Street yesterday was that WaMu's woes had been much worse than had previously been stated suggesting that the bank's mortgage meltdown had gotten worse."

In early June, Peter Moriera of the Daily Deal reported that Kerry Killinger, WaMu's chairman, had stepped down, although he would continue as their chief executive officer.

> "Seattle-based Washington Mutual has suffered even more than Wachovia, with its shares losing 80% of their value in the last year. The thrift, which in April raised $7 billion in capital from a group led by TPG Group, on Monday named independent director Stephen E. Frank to succeed Killinger in the role of chairman."

Late Summer 2008

Eventually, more information about WaMu's financial condition began to emerge. On September 12th, Jonathan Stempel of *The Globe and Mail* in a story by reported,

> "Washington Mutual reported a $3.33-billion second-quarter loss. It has said mortgage losses could reach $19-billion through 2011. The Seattle-based thrift raised $7-billion this year from investors led by private equity firm TPG Inc., but the falling stock price could make any new capital too costly." As noted in the same article, financial markets were processing this new information as well. The article says, "Washington Mutual shares are down 92 per cent in the last year. Its "distressed" 5.25 per cent notes maturing in 2017 fell 2 cents on the dollar to 44 cents, pushing its yield up to 18.08 per cent from 15.87 per cent, according to MarketAxess."

On the other hand, as Mr. Stempel writes, "Mr. Fishman said Monday that there had been 'no dramatic movements' in deposit flows at the thrift. Mr. Egan (manager of the ratings desk at Egan-Jones Ratings Co.) said: 'There has to be concern about how well WaMu can retain its deposit base, which is the lifeblood of the institution.'" Thus, while sentiment was turning negative, the main source of financing for the bank, deposits, had not moved yet.

In terms of WaMu's stock, a September 16th article by Heath and Applebaum in *The Washington Post* reported,

> "Washington Mutual yesterday closed at $2 per share, down 27 percent on the day. The stock is 95 percent off its 52-week high. Standard & Poor's downgraded the company's credit rating to junk status, citing the deteriorating housing market."

In terms of the size of the potential failure, the article quotes Rich X. Bove, an analyst at Ladenburg Thalmann & Co.

> "'The cost to the FDIC if this company fails is likely to be quite high,' analyst Rich X. Bove of Ladenburg Thalmann wrote. He estimates the net cost to the FDIC at $24 billion, which is about half of the assets in the FDIC's insurance fund." On the other hand, in the same article, a hedge fund manager from Hovde Financial states, "'Does WaMu have problems? Yes,' said Hovde, who said he has no stake in the company. 'But fundamentally, they shouldn't be in a position of failing but for the press and others whipping up the fear on a failure. They are meeting their tangible capital requirements today. They have a much better funding structure [than Lehman], and it's a much more regulated entity. You can't compare WaMu to Lehman.'"

As the days passed, TPG allowed WaMu to seek out other capital to bolster the firm. As reported in *The Evening Standard*, "U.S. building society Washington Mutual is said to be closer to sale today after its largest investor, private equity firm TPG, agreed to let it raise capital, even if that meant diluting the group's holdings."

Early fall 2008

Further information on WaMu can be gleaned from the Office of Thrift Supervision (OTS) Fact Sheet released on September 25th. Significantly, the fact sheets states,

> "Because of adverse events in the financial markets, material outflows began on September 15, 2008. Coupled with further rating agency downgrades of Washington Mutual Inc. (WMI, the top-tier holding company) and Washington Mutual Bank (WMB or the Bank), the Bank experienced a net deposit loss of $16.7 billion through September 24, 2008."

Thus, the lack of deposit outflows noted above on September 12th were now happening. The Fact Sheet also gives a glimpse into the past lending strategy of WaMu and how it has evolved over the crisis.

> "Beginning in late 2006 through today, WMB was proactively changing its business strategy to respond to declining housing and market conditions. Changes included tightening credit standards, eliminating purchasing and originating subprime mortgage loans, and discontinuing underwriting option ARM and stated income loans. Management reduced loans originated for sale and transferred held for sale loans to the held for investment portfolio. WMB was focusing on shrinking its balance sheet and developing a retail strategy through its branch operations."

Upon reflection, many wondered if the change came too late.

Unfortunately, the answer was 'yes.' WaMu's portfolio consisted of so many failing mortgages that it could not save itself from these past mistakes. As noted in The Daily Telegraph on September 27th by Harry Wallop,

"Washington Mutual, once America's biggest savings and loan bank, has become the largest victim of the credit crisis after regulators shut it down over fears that it was suffering from a crippling run. … Washington Mutual was closed by the federal Office of Thrift Supervision on Thursday evening after customers withdrew $16.7 billion (pounds 9.07 billion) from accounts over the previous 10 days leaving the bank 'unsound', according to the regulator."

As a way out of this failure, the FDIC arranged the sale of WaMu to JP Morgan Chase. On September 29th, *Business World* provided a fitting epitaph for WaMu's headstone,

> "According to the petition [for bankruptcy], Washington Mutual is being represented by New York law firm Weil Gotshal and Manges, which also represents Lehman Brothers Holdings Inc in its Chapter 11 case. Its subsidiary, WMI Investment Corp, also filed for bankruptcy protection, Washington Mutual said in a statement. The bankruptcy filing is a procedural step, as Washington Mutual was closed by the U.S. government this week in the largest U.S. bank failure in history. Its banking assets were sold to JPMorgan Chase & Co for USD 1.9 billion."

WHAT HAPPENED TO WAMU?

With this understanding of how banks manage their balance sheet and some perspective on the timeline of events, we can now turn and ask some questions surrounding the downfall of WaMu.[5] Please consider the following:

1) Looking at WaMu's balance sheet in Exhibit 1 in Appendix 1, as of 12/31/07, describe the type of funding they used and where they invested those funds. How does that change as of 6/30/08? What are the implications of the changes? It may be helpful to think of the stability of the different types of liabilities that have and how changes in their investment values may affect access to those funds.
2) Examine WaMu's income statement on 6/30/07 in Exhibit 2 in Appendix 1. What are major sources of income and what are their major expenses? What has changed on 6/30/08 from the same period the previous year? In addition to major categories of revenues and expenses, what categories show the most period-to-period change? How might these changes translate to changes on their balance sheet?
3) What was the cause of these changes to the assets on their balance sheet? For this, you can use your own background knowledge of the financial crisis and glean information from the timeline above which draws on Appendices 3 through 5 at the end of the case. Note types of assets they hold and how those may differ from conventional loans and even from other types of subprime mortgages. Because of changes to their assets, how did they try and shore up their sources of funding?
4) At the point of 6/30/08, without considering what you know occurs after that date, does WaMu seem to be financially unsound? Remember that being unsound or not a viable concern is different than being a company whose performance with which you, as an investor, would be happy. In this context, how would you view WaMu if you were a regulator? Do you think WaMu could conceivably have turned things around for the better? If so, or if not, why?
5) By the end of September 2008, WaMu was sold to JP Morgan (see the timeline above which draws on Appendices 10 and 11). What events occurred after 6/30 (glean information from the timeline above which draws on Appendices 6 through 9) that affected WaMu's balance sheet and its financial condition? What was the final 'nail in the coffin' so to speak? How did these changes lead to WaMu's failure and sale?

[5] Financial data is from Sec.gov. Washington Mutual form 10-Q for June 30, 2008. United States Securities and Exchange Commission.

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Appendix 1

Exhibit 1: Washington Mutual - Balance Sheet (dollars in millions)			
Assets	6/30/08		12/31/07
Cash and cash equivalents	7,235		9,560
Federal funds sold and securities purchased under agreements to resell	2,750		1,877
Trading assets	2,308		2,768
Available-for-sale securities			
Mortgage-backed securities	18,241		19,249
Investment securities	6,134		8,291
Total available-for-sale securities	24,375		27,540
Loans held for sale	1,877		5,403
Loans held in portfolio	239,627		244,386
Allowance for loan losses	-8,456		-2,571
Loans held in portfolio, net	231,171		241,815
Investment in Federal Home Loan Banks	3,498		3,351
Mortgage servicing rights	6,175		6,278
Goodwill	7,284		7,287
Other assets	23,058		22,034
Total assets	309,731		327,913
Liabilities			
Deposits:			
Noninterest-bearing deposits	31,112		30,389
Interest-bearing deposits	150,811		151,537
Total deposits	181,923		181,926
Federal funds purchased and commercial paper	75		2,003
Securities sold under agreements to repurchase	214		4,148
Advances from Federal Home Loan Banks	58,363		63,852
Other borrowings	30,590		38,958
Other liabilities	8,566		8,523
Minority interests	3,914		3,919
Total liabilities	283,645		303,329
Stockholders' Equity			
Preferred stock	3,392		3,392
Common stock, no par value	–		–
Capital surplus – common stock	12,916		2,630
Accumulated other comprehensive loss	-1,079		-359
Retained earnings	10,857		18,921
Total stockholders' equity	26,086		24,584
Total liabilities and stockholders' equity	309,731		327,913

On June 30, 2008, the Company's Tier 1 capital to average total assets ratio was 7.76%, and its total risk-based capital to total risk-weighted assets ratio was 13.93%, exceeding the regulatory guidelines for well-capitalized institutions, and the tangible equity to total tangible assets ratio was 7.79%, above the Company's established target of 5.50%.

Exhibit 2: Washington Mutual - Income Statement (dollars in millions)

	Three Months Ended 30-Jun		Six Months Ended 30-Jun	
	2008	2007	2008	2007
Interest Income				
Loans held for sale	52	421	138	984
Loans held in portfolio	3,604	3,786	7,559	7,686
Available-for-sale securities	335	351	691	682
Trading assets	117	108	233	221
Other interest and dividend income	94	82	171	183
Total interest income	4,202	4,748	8,792	9,756
Interest Expense				
Deposits	1,115	1,723	2,443	3,495
Borrowings	791	991	1,878	2,146
Total interest expense	1,906	2,714	4,321	5,641
Net interest income	2,296	2,034	4,471	4,115
Provision for loan losses	5,913	372	9,423	606
Net interest income (expense) after provision for loan losses	-3,617	1,662	-4,952	3,509
Noninterest Income				
Revenue - sales and servicing of home mortgage loans	-109	300	302	425
Revenue from sales and servicing of consumer loans	159	403	407	846
Depositor and other retail banking fees	767	720	1,470	1,385
Credit card fees	177	183	358	355
Securities fees and commissions	64	70	122	131
Insurance income	32	29	63	58
Loss on trading assets	-305	-145	-521	-253
Gain (loss) on other available-for-sale securities	-402	7	-384	41
Gain (loss) on extinguishment of borrowings	100	-14	113	-7
Other income	78	205	199	318
Total noninterest income	561	1,758	2,129	3,299
Noninterest Expense				
Compensation and benefits	939	977	1,853	1,979
Occupancy and equipment	460	354	818	731
Telecommunications and outsourced information services	123	132	253	261
Depositor and other retail banking losses	61	58	124	119
Advertising and promotion	103	113	208	211

Professional fees	57	55	96	93
Foreclosed asset expense	217	56	372	95
Other expense	443	393	831	755
Total noninterest expense	2,403	2,138	4,555	4,244
Minority interest expense	75	42	151	85
Income (loss) before income taxes	-5,534	1,240	-7,529	2,479
Income taxes	-2,206	410	-3,063	865
Net Income (Loss)	-3,328	830	-4,466	1,614
Net Income (Loss) Applicable to Common Stockholders	-6,689	822	-7,892	1,599
Earnings Per Common Share:				
Basic	-6.58	0.95	-8.43	1.83
Dividends declared per common share	0.01	0.55	0.16	1.09
Basic weighted average number of shares (thousands)	1,016,081	868,968	936,502	871,876

Appendix 2

WALL STREET JOURNAL
March 18, 2008 Tuesday

NATIONAL CITY, WAMU HIT HARD AS WORRY SLAMS MIDTIER LENDERS
BYLINE: Valerie Bauerlein
SECTION: Section C; Column 1; Pg. 3

Investors turned to an often overlooked corner on Wall Street: midsize and regional banks such as National City Corp. and Washington Mutual Inc., whose shares were hammered as fears spread that they could be in new danger from the expanding financial crisis.

National City fell 43%, or $5.63, to $7.52 as of 4 p.m. in New York Stock Exchange composite trading, amid speculation the Cleveland company has put itself up for sale but has been unable to find a buyer. National City disclosed it has hired Goldman Sachs Group Inc. as a "capital adviser" but declined to comment on sale speculation.

National City attributes the slide in shares to "the market's reaction to the Bear Stearns announcement," a spokeswoman said.

Washington Mutual shares dropped 13%, or $1.35, to $9.24 on the NYSE, after Moody's Investors Service cut the company's debt rating Friday to one step above junk status.

Analysts struggled yesterday to predict how the market gyrations would play out among the midtier banks. "Among people's big concerns is the pressing need for capital in the U.S. banking system," Chris Low, chief economist for FTN Financial, said in a research report. "How can banks raise capital after this example?"

Some bank executives said the federal government's role in encouraging the Bear Stearns Cos. bailout and providing as much as $30 billion in financing make it much more likely that buyers will wait for similar incentives or forbearance on their own capital levels.

Others said the forceful role of banking regulators in structuring the deal for J.P. Morgan Chase & Co. to acquire Bear Stearns means the government will move aggressively to stop a domino effect of bank failures.

"What the Bear Stearns news means is, the federal government is not going to allow significant financial institutions to fail, and that would include WaMu," said analyst Frederick

Cannon at Keefe, Bruyette & Woods. "Could there be a potential forced sale of WaMu? It's not my expectation, but clearly it's possible."

To be sure, few analysts and investors say they expect the failure of any sizable U.S. banks, or those with a market value of $1 billion or more. What is more likely, they said, is that the Federal Deposit Insurance Corp., which insures bank deposits, and other regulators would encourage sales and negotiate incentives.

Christopher Marinac, research director of Atlanta firm FIG Partners LLC, said investors are waiting to recapitalize until the extent of problems is clearer. "A lot of investors have told us they'd rather wait until we know what all the issues are and have kicked out the problem children," he said.

Some smaller banks find themselves beset by doubts about whether they have revealed the depth of potential problems, making it difficult to raise needed capital and fix operations. That can create a spiral as hedge-funds and other investors become reluctant to invest, and potential buyers prefer to work on credit issues of their own and wait for distressed prices to fall even further.

One thing is clear: Regulators are pressuring banks of all sizes to air their dirty laundry now. Regulators have been increasingly vocal about the need for banks to raise capital. Bankers said regulators are taking an increasingly hands-on approach in evaluating their loan portfolios. So what banks are in trouble? National City and WaMu top many investors' lists.

Analyst David Hilder of Bear Stearns cites banks with big real- estate exposure relative to their asset size. WaMu has 71% of its loans in real estate, compared to 51% for National City and 47% for Huntington Bancshares Inc. of Columbus, Ohio. according to Mr. Hilder.
But further losses in the option-ARM mortgage portfolio of Downey Financial Corp., a small bank in Newport Beach, Calif., contributed to concerns that the crisis is deepening. Downey reported nonperforming assets of 10.93%, significantly higher than the loss rate during the housing crunch of the early 1990s.

Moody's predicted WaMu would have to set aside loan-loss reserves of $12 billion, far more than previously predicted. WaMu has cut jobs and its dividend and raised $3.7 billion in preferred shares, limiting its options. The company declined to comment on market speculation. So far, WaMu has shown no signs of a drain of customers like the one that presaged meltdowns at Bear and Countrywide Financial Corp., which agreed to be sold to Bank of America Corp. for $4 billion in January.

Many investors fear that National City may face significant losses at the end of the current quarter March 31, on troubled assets, perhaps including some of the remaining $6 billion in loans it held on to when it sold First Franklin Financial Corp., the subprime lender.

Appendix 3

The International Herald Tribune
April 8, 2008 Tuesday
Washington Mutual to get cash injection; Reports link TPG to $5 billion deal
SECTION: FINANCE; Pg. 14
DATELINE: NEW YORK

Washington Mutual, the largest U.S. savings and loan, rallied in New York trading Monday on reports that a group led by the private equity firm TPG was considering a $5 billion investment in the Seattle-based institution.

An investment would ease Washington Mutual's need for capital as losses soared from the subprime mess. Washington Mutual has reported more than $3 billion in home-mortgage write-downs and loan losses.

The investment could be a sign of recovering confidence in banking, but would also expose TPG, formerly Texas Pacific Group, to losses if Washington Mutual's business soured further.

An investment would give TPG a mix of common and preferred stock, totaling fewer than 25 percent of Washington Mutual's outstanding shares, according to one person cited by The Associated Press, who asked not to be named because the deal has not been announced.

TPG would also get a seat on Washington Mutual's board, the person said. Other investors include existing Washington Mutual institutional shareholders and other private equity groups, the person said.

Reuters quoted two people as saying a transaction could be announced as soon as Monday. They declined to be named because they were not authorized to speak.

Shares of Washington Mutual rose $3.63, or 35.7 percent, to $13.80 in midday trading in New York.

Washington Mutual would join more than a dozen commercial and investment banks to seek cash from outside investors in the past year, after more than $200 billion in write-downs and credit losses tied to the U.S. housing and credit crisis.

TPG and Washington Mutual declined to comment.

The Wall Street Journal reported the deal in Monday editions.

Washington Mutual lost $1.87 billion in the fourth quarter of 2007, hurt by exposure to housing markets like California and Florida.

Analysts expect more losses at least through 2008, and several have said Washington Mutual has not set aside enough to cover bad loans.

While Washington Mutual has pared its exposure to subprime and other riskier home loans, it did not do so fast enough, and losses soared as credit markets shut down.

For Kerry Killinger, chief executive of Washington Mutual, the TPG investment could provide breathing room as he cuts costs elsewhere. Washington Mutual's board decided earlier this year that mortgage-related credit losses and foreclosure costs would not count in setting his performance bonus.

If the deal goes through, Washington Mutual would be one of the first retail banks to get outside funding, with hopes of distancing itself from the subprime crisis. So far, it has been mostly investment banks holding huge positions in bad mortgages that have received outside help.

Merrill Lynch announced in January that it would take $6.6 billion from three foreign investment funds. Morgan Stanley sold a portion of itself to China Investment Corp., an investment arm of the Chinese government, for $5 billion in December. And in November, Citigroup took $7.5 billion from the Abu Dhabi Investment Authority in exchange for as much as 4.9 percent of its equity.

Banks are also issuing new shares to increase capital. Last week, Lehman Brothers raised $4 billion in a stock offering and the Swiss banking giant UBS announced plans to seek $15.1 billion.

Appendix 4

The New York Post
April 9, 2008 Wednesday
WAMU RESCUE NOT ENOUGH, SHARES FALL 10%
BYLINE: MARK DeCAMBRE
SECTION: All Editions; Pg. 37

Washington Mutual may have staved off a buyout with its multibillion-dollar capital injection but the cash-strapped savings and loan is far from home free.

The Seattle-based bank saw its stock drop about 10 percent in trading yesterday after the firm formally announced a $7 billion cash infusion, which includes a $2 billion investment from TPG - a private-equity firm led by wealthy investors David Bonderman and Jim Coulter. Positive sentiment had buffeted the bank's depressed shares by nearly 30 percent on Monday when word of the deal began to emerge.

However, the overriding outlook on the Street yesterday was that WaMu's woes had been much worse than had previously been stated suggesting that the bank's mortgage meltdown had gotten worse.

"This substantial new capital - along with the other steps we are announcing today - will position us for a return to profitability as these elevated credit costs subside," WaMu CEO Kerry Killinger said in a statement.

But a painful contraction in the US markets has added to further slippage in mortgages, and that has been a bad recipe for WaMu, suggesting that the worst of the credit crisis may be far from over.

WaMu set aside $3.5 billion in funds in order to brace for further losses in housing and plans on writing down $1.5 billion in debt because values have fallen. WaMu is expected to report first-quarter earnings on Tuesday.

WaMu's cash injection also includes a plan to cut 3,000 jobs and slash its dividend to a penny, which it says will save it approximately $490 million annually. It also plans to stop making loans with third-party brokers. A TPG spokesman declined to comment.

Appendix 5

Daily Deal/The Deal
June 3, 2008 Tuesday
Wachovia board ousts CEO
BYLINE: by Peter Moreira
SECTION: M AND A
HIGHLIGHT: Wachovia sacks Thompson as Washington Mutual deprives CEO Killinger of his roll as chairman.

The credit crisis on Monday, June 2, took its told on lending giants Wachovia Corp. and Washington Mutual Inc., both of which announced changes in their top executives.

Wachovia, the fourth-largest U.S. bank, said its board had ousted chief executive Ken Thompson, who has been under fire in part because of his ill-advised $24 billion purchase of Golden West Financial Corp. in 2006.

Hours later, WaMu, the country's largest savings and loan, said Kerry Killinger will step down as chairman though he will retain his title as chief executive.

Both the lenders are among the U.S. banks that have had to raise capital and suffered huge losses in share prices after writing off bad loans, largely because of the collapse of residential real estate markets.

Charlotte, N.C.-based Wachovia said in a statement Monday morning that Thompson will be succeeded on an interim basis by chairman Lanty Smith. Ben Jenkins, currently vice-chairman and president of the banking unit, will serve as interim chief operating officer.

"No single precipitating event caused the board to reach this decision, but a series of previously disclosed disappointments and setbacks cumulatively have negatively impacted the company and its performance," said Smith in the statement. ``The board believes new leadership will help to revitalize and reenergize Wachovia and enable it to realize its potential."

The board has struck a committee to find a new full-time chief executive. The bank - which is exceeded in size by Citigroup Inc., J.P. Morgan Chase & Co.,and Bank of America Corp.- has upset investors recently after its shares have fallen 54% in the past year due to the credit crisis. Wachovia was especially hard hit in part because it bought Golden West, whose two main markets were California and Florida - two markets suffering badly from mortgage foreclosures.

Thompson had admitted previously that the purchase was ``ill-timed".

In April, the bank reported a $393 million first-quarter loss, cut its dividend and announced plans to raise about $7 billion in equity to shore up its balance sheet. Then a month later, it increased the size of that loss 80% to $708 million because of writedowns for bank-owned insurance policies and said the issue of new capital was $8 billion.

Wachovia shares, which fell 1.5% to $23.80 on Friday, lost a further 3.3% to $23.01. As one of the largest subprime mortgage lenders, Seattle-based Washington Mutual has suffered even more than Wachovia, with its shares losing 80% of their value in the last year. The thrift, which in April raised $7 billion in capital from a group led by TPG Group, on Monday named independent director Stephen E. Frank to succeed Killinger in the role of chairman.

WaMu also adopted a majority voting standard for its board and made several changes to the composition and leadership of board committees.

Frank, 66, has served on WaMu's board since 1997, most recently as the company's lead independent director. He is the retired chairman, president and CEO of Southern California Edison.

"These steps are just a few among many we are taking this year to make this a positive turning point for WaMu," said Killinger in the statement. ``In addition to these actions, we are, of course, aggressively implementing our plans for operational and financial recovery -- including maintaining ample capital and a high level of liquidity, significantly reducing our operating expenses, and continuing to grow our profitable, core retail bank."

Several U.S. banks have forced out their top executives following disastrous plunges in their shares in the past few months, including Citigroup's Charles O. Prince and Merrill Lynch & Co.'s Stanley O'Neal.

In early trading, WaMu shares were up 0.1% at $9.03.

Appendix 6

The Globe and Mail (Canada)
September 12, 2008 Friday

Options narrow to get capital for battered U.S. thrift; Washington Mutual's survival hopes dim
BYLINE: JONATHAN STEMPEL, Reuters
SECTION: REPORT ON BUSINESS: INTERNATIONAL; FINANCIAL SERVICES; Pg. B11
DATELINE: NEW YORK

Washington Mutual Inc. shares sank below $2 (U.S.) for the first time since 1990 as anxiety grew about its capital needs and survival prospects, before staging a powerful late rally.

The thrift's shares closed up 51 cents or 22 per cent at $2.83 on the New York Stock Exchange, after earlier trading as low as $1.75. Despite the late jump, they were down 34 per cent since Monday, when Washington Mutual named Alan Fishman its new chief executive officer.

"WaMu was another battered bank stock that many investors believed could be the next one which might not survive," said William Lefkowitz, options strategist at brokerage firm vFinance Investments. "Some investors might have felt that WaMu has been punished enough for the short term."

Washington Mutual reported a $3.33-billion second-quarter loss. It has said mortgage losses could reach $19-billion through 2011.

The Seattle-based thrift raised $7-billion this year from investors led by private equity firm TPG Inc., but the falling stock price could make any new capital too costly.

"Unfortunately, their options have narrowed significantly, even over the past two days," said Sean Egan, manager of the ratings desk at Egan-Jones Ratings Co.

"What is ideal is an investment well in excess of $10-billion, probably closer to $15-billion or $20-billion, with the hope of additional investments over time," he said. "Few investors can write a ticket that large, and even fewer have the ability to move quickly."

Washington Mutual spokesman Brad Russell declined to comment. TPG spokesman Owen Blicksilver also had no comment.

Washington Mutual shares are down 92 per cent in the last year. Its "distressed" 5.25 per cent notes maturing in 2017 fell 2 cents on the dollar to 44 cents, pushing its yield up to 18.08 per cent from 15.87 per cent, according to MarketAxess.

Earlier this week, Washington Mutual said the Office of Thrift Supervision has stepped up its oversight into how the thrift manages risk.

Richard Bove, a Ladenburg Thalmann & Co. analyst, suspended his "neutral" rating on WaMu yesterday, citing uncertainty about what the OTS ordered the thrift to do.

Analysts have said the thrift may be starved for buyers because of an accounting rule that takes effect in December. The rule will force buyers to write down assets of targets to market prices, perhaps requiring them to raise costly capital.

Moreover, a clause in the TPG agreement complicates any capital raising. WaMu must cover any dilution in TPG's investment if the thrift is sold, or if it raises more than $500-million of equity, for less than $8.75 a share - within 18 months of the infusion.

It is unclear how customers are reacting.

Mr. Fishman said Monday that there had been "no dramatic movements" in deposit flows at the thrift. Mr. Egan said: "There has to be concern about how well WaMu can retain its deposit base, which is the lifeblood of the institution."

Appendix 7

The Washington Post
washingtonpost.com
The Washington Post
September 16, 2008 Tuesday
Suburban Edition

Washington Mutual's Rating Cut to Junk; Failure Could Cost FDIC Insurance Fund $24 Billion to Cover Depositors, Estimates Say
BYLINE: Thomas Heath and Binyamin Appelbaum; Washington Post Staff Writers
SECTION: FINANCIAL; Pg. D03

The credit crisis that yesterday pushed Lehman Brothers to file for bankruptcy and drove Merrill Lynch into the arms of Bank of America has many on Wall Street looking at other troubled financials.

Washington Mutual, the Seattle-based savings and loan giant whose stock has been hammered the past week, has raised concern because its demise would be the largest bank failure in U.S. history, putting stress on the Federal Deposit Insurance Corp. to cover depositors.

Washington Mutual yesterday closed at $2 per share, down 27 percent on the day. The stock is 95 percent off its 52-week high. Standard & Poor's downgraded the company's credit rating to junk status, citing the deteriorating housing market.

"The cost to the FDIC if this company fails is likely to be quite high," analyst Rich X. Bove of Ladenburg Thalmann wrote. He estimates the net cost to the FDIC at $24 billion, which is about half of the assets in the FDIC's insurance fund.

The FDIC doesn't comment on specific cases, but a spokesman said yesterday that the fund has sufficient resources to cover the failure of a very large bank. In most cases, the FDIC promises to guarantee deposits up to $100,000. The government regards that promise as sacred. The FDIC might just have to borrow money from the Treasury Department to meet its obligations to depositors.

"We're confident that our resources would be more than adequate to cover any losses from bank failures," FDIC spokesman Andrew Gray said.

Washington area hedge fund managers who specialize in financial firms think the chances of Washington Mutual seeking bankruptcy protection are unlikely. Even if the bank does go under, they said, the FDIC could endure the hit.

"The loss can be absorbed by common shareholders, preferred shareholders and bondholders, in that order, before you get to the deposit insurance," said Gary Townsend of Hill-Townsend Capital, a Chevy Chase hedge fund that concentrates on financials. "I assume that's not enough to break the [FDIC] bank."

Eric D. Hovde of Hovde Financial, a District hedge fund that trades in bank stocks, said Washington Mutual should not be lumped in with Lehman Brothers because he said it has billions of dollars in savings account deposits that make it less vulnerable.

"Does WaMu have problems? Yes," said Hovde, who said he has no stake in the company. "But fundamentally, they shouldn't be in a position of failing but for the press and others whipping up the fear on a failure. They are meeting their tangible capital requirements today. They have a much better funding structure [than Lehman], and it's a much more regulated entity. You can't compare WaMu to Lehman."

TPG, one of the country's largest private-equity funds, bought a 14 percent stake in Washington Mutual earlier this year and presumably could buy more.

"Likely, when push comes to shove, they would make a further investment to keep the ship afloat," Townsend said.

A TPG spokesman had no comment.

A Washington Mutual spokesman also declined to comment.

The FDIC's insurance fund had assets of $45.2 billion at the end of June. Extrapolating from the average cost of all bank failures over the past decade, based on FDIC data, that was enough to cover the failure of banks with total assets of $288 billion. Washington Mutual alone had assets of more than $350 billion at the end of June.

Gray said that under some circumstances, the FDIC might turn to the Treasury for short-term loans to cover the initial costs of a failure, which it would then repay as it processed the failure and was able to replenish the insurance fund. He said the FDIC last accessed such funding in the early 1990s.

There have been only 11 bank failures this year, but industry consolidation means the average failed bank is now several times as large as ones that collapsed in the early 1990s.

The FDIC said it regarded 117 institutions as troubled at the end of June. It does not disclose the names of banks on the list.

The agency's board of directors will consider at its October meeting raising the insurance premiums that banks are charged. The insurance rates are set on a sliding scale based on the financial health of the bank; weaker banks pay more, reflecting the greater risk of a failure. Gray said the increase would be likely to raise rates disproportionately for those banks to make sure the weight of the increase was carried primarily by the banks at greatest risk of failure.

The Office of Thrift Supervision, which regulates Washington Mutual, has expressed increased concern about the company. The bank disclosed earlier this month that it had a "memorandum of understanding" with the regulator, requiring the company to improve its risk management and submit a business plan showing how it plans to address problems.

After Moody's downgraded the company's stock on Thursday, Washington Mutual issued a statement saying the downgrade was "inconsistent with the company's current financial condition."

Washington Mutual is in trouble primarily because of its role in selling option ARMs, mortgage loans with payment terms that resemble a credit card, allowing the borrower to pay less than the total due each month. The default rates on such loans more closely resemble the high failure rates on credit cards than the low failure rates on conventional mortgage loans.

Appendix 8

The Evening Standard (London)
September 18, 2008 Thursday
A Edition

Lossmaking Washington Mutual may soon be on the market; BANKING
SECTION: Pg. 29

US BUILDING society Washington Mutual is said to be closer to sale today after its largest investor, private equity firm TPG, agreed to let it raise capital, even if that meant diluting the group's holdings.

But a sale will still be difficult.

Washington Mutual has lost $6.3 billion (£3.49 billion) in the last three quarters of the year and was downgraded to junk status by credit rating agencies.

The firm has projected $19 billion of mortgage losses up to 2011.

Last week, Washington Mutual said it expected to set aside $4.5 billion for credit losses in the third quarter, down from the second quarter's $5.9 billion, and added that it expected to remain well capitalised.

A sale became more likely after Washington Mutual named Alan Fishman as chief executive, replacing the ousted Kerry Killinger who had long set his heart on the firm remaining independent.

JPMorgan Chase chief executive Jamie Dimon is considered the most likely acquirer, as he has made no secret of his aim to expand the Chase brand on the West Coast.

A sale is far from assured until there is more clarity about Washington Mutual's mortgage losses.

Appendix 9

Office of Thrift Supervision
FACT SHEET

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FOR RELEASE: Thursday, September 25, 2008
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OTS Fact Sheet on Washington Mutual Bank
Institution Profile

- Total assets as of June 30, 2008: $307.02 billion
- Primary executive and business segment headquarters are located in Seattle, Washington.
- Branches: 2,239 retail branch offices operating in 15 states
- 4,932 owned and branded ATMs
- Employees: 43,198 at June 30, 2008

Recent Deposit Flows

- Because of adverse events in the financial markets, material outflows began on September 15, 2008. Coupled with further rating agency downgrades of Washington Mutual Inc. (WMI, the top-tier holding company) and Washington Mutual Bank (WMB or the Bank), the Bank experienced a net deposit loss of $16.7 billion through September 24, 2008.

Other Financial Details (as of June 30, 2008)

- Total deposits: $188.3 billion
- Brokered deposits: $34.04 billion
- Total borrowings: $82.9 billion primarily comprising Federal Home Loan Bank advances of $58.4 billion and $7.8 billion of subordinated debt
- Loans held: $118.9 billion in single-family loans held for investment - this includes $52.9 billion in payment option ARMs and $16.05 billion in subprime mortgage loans
- Home Equity Lines of Credit (HELOCs): $53.4 billion
- Credit Card Receivables: $10.6 billion
- Total loan servicing: $689.7 billion total loans serviced, including $442.7 billion in loans serviced for others and $26.3 billion of subprime mortgage loans
- Non-performing assets: $11.6 billion, including $3.23 billion payment option ARMs and $3.0 billion subprime mortgage loans

Institution History

- WMI is the top-tier savings and loan holding company and owns two banking subsidiaries, WMB and Washington Mutual Bank, fsb (WMBfsb), as well as nonbank subsidiaries.
- Since the early 1990s, WMI expanded its retail banking and lending operations organically and through a series of key acquisitions of retail banks and mortgage companies. The majority of growth resulted from acquisitions between 1996 and 2002. On October 1, 2005, the Bank entered the credit card lending business by acquiring Providian Financial Corporation. These acquisitions enabled WMB to expand across the country, build its customer base, and become the largest savings and loan association in the country.
- The Bank had four business segments: the Retail Banking Group, the Card Services Group, the Commercial Group and the Home Loans Group. WMB is a leading originator and servicer of both single- and multi-family mortgages and a major issuer of credit cards.

Recent Events

- *Changes in Business Strategy* - Beginning in late 2006 through today, WMB was proactively changing its business strategy to respond to declining housing and market conditions. Changes included tightening credit standards, eliminating purchasing and originating subprime mortgage loans, and discontinuing underwriting option ARM and stated income loans. Management reduced loans originated for sale and transferred held for sale loans to the held for investment portfolio. WMB was focusing on shrinking its balance sheet and developing a retail strategy through its branch operations.
- *Reduction of Overhead Expenses* - In December 2007, WMB announced the resizing of its Home Loans business including the elimination of approximately 2,600 employee positions, closure of approximately 190 home loan centers and sales offices, and closure of nine loan processing and call centers.
- *Maintaining Capital* - In late 2006 and 2007, WMB began to build its capital level through asset shrinkage and the sale of lower-yielding assets. In April 2008, WMI received $7.0 billion of new capital from the issuance of common stock. Since December

2007, WMI infused $6.5 billion into WMB. WMB met the well capitalized standards through the date of receivership.

- *Operating Losses* - WMB recorded a net loss of $6.1 billion for the three quarters ended June 30, 2008. In the second quarter of 2008, WMB management disclosed that the Bank's credit quality had deteriorated and it might incur up to $19 billion in losses on its single-family residential mortgage portfolio. WMB increased its loan loss provisioning in response to the deteriorating housing market. Loan loss provisions increased from $1.6 billion in the fourth quarter of 2007, to $3.6 billion in the first quarter of 2008 and $6.0 billion in the second quarter of 2008.
- *Deposit Outflows* – Since July 2008, the pressure on WMB increased as market conditions continued to worsen. Significant deposit outflows began on September 15, 2008. During the next eight business days, WMB deposit outflows totaled $16.7 billion, shortening the time available to augment capital, improve liquidity, or find an equity partner. Given the Bank's limited sources of funds and significant deposit outflows, it was highly likely to be unable to pay its obligations and meet its operating liquidity needs.
- *Receivership* - With insufficient liquidity to meet its obligations, WMB was in an unsafe and unsound condition to transact business. OTS placed WMB into receivership on September 25, 2008. WMB was acquired today by JPMorgan Chase. The change will have no impact on the bank's depositors or other customers. Business will proceed uninterrupted and bank branches will open on Friday morning as usual.

OTS Enforcement Actions

- October 17, 2007 – Issued a Cease and Desist Order related to deficiencies in Bank Secrecy Act/Anti-Money Laundering (BSA/AML) programs
- October 17, 2007 – Assessed Civil Money Penalties (CMPs) related to violation of flood insurance regulations
- November 14, 2007 – Initiated a formal examination of the appraisal process to assess the validity of a complaint filed by the New York Attorney General's (NYAG) Office
- February 27, 2008 – Issued overall composite ratings downgrade and received a Board resolution in response to the supervisory action
- June 30, 2008 – Initiated discussions about Memorandums of Understanding with WMI and WMB
- September 7, 2008 - Issued Memorandums of Understanding to WMI and WMB
- September 18, 2008 – Issued overall composite ratings downgrade

OTS Profile
Established - 1989
Thrift institutions supervised as of June 30, 2008 - 829
Thrift industry assets supervised as of June 30, 2008 - $1.51 trillion
OTS employees - 1,055
Washington Mutual Bank assessment revenue – 12.2 percent of 2008 OTS budget

Appendix 10

The Daily Telegraph

The Daily Telegraph (London)
September 27, 2008 Saturday

WASHINGTON MUTUAL; Crisis claims biggest victim and more could fall
BYLINE: Harry Wallop Consumer Affairs Editor
SECTION: NEWS; Financial Crisis; Pg. 4

WASHINGTON MUTUAL, once America's biggest savings and loan bank, has become the largest victim of the credit crisis after regulators shut it down over fears that it was suffering from a crippling run.

The seizure by regulators is the latest indicator that big financial institutions could continue to fall like dominoes unless a bail-out deal is struck in Congress. The Seattle-based bank, universally known as WaMu, came to symbolise the excesses of the US housing market bubble, after it lent over-generous mortgages to thousands of customers who were unable to repay the loans.

Kerry Killinger, the bank's former chief executive, explicitly set out to become the "The Wal-Mart of Banking", but it soon ended up with mounting bad debts as mortgage and credit card customers started to default.

Washington Mutual was closed by the federal Office of Thrift Supervision on Thursday evening after customers withdrew $16.7 billion (pounds 9.07 billion) from accounts over the previous 10 days leaving the bank "unsound", according to the regulator.

After the collapse of Lehman Brothers, customers started to withdraw their money in increasing numbers, raising the spectre of a full-scale run on the bank in the same way that Northern Rock suffered in Britain last year.

WaMu has about $307 billion (pounds 169 billion) of assets and $188 billion (pounds 102 billion) of deposits, regulators said, which makes its collapse by far and away the largest in US history, dwarfing the failure of Continental Illinois National Bank & Trust, which had $40 billion (pounds 21.7 billion) assets when it collapsed in 1984.

JP Morgan Chase has stepped in to buy most of WaMu's assets, averting a potentially enormous bill for taxpayers.

JP Morgan Chase, which acquired Bear Stearns only six months ago in another shotgun deal brokered by the government, is paying $1.9 billion (pounds 1.03 billion), which will secure customers' savings. It will take on most of the bank's branches.

The seizure and sale of WaMu is the latest attempt by the US government to save a banking industry brought to its knees by toxic mortgage debt.

Since the sub-prime crisis started, a series of bank takeovers and failures have transformed the American financial system. These include the rushed acquisitions of Bear Stearns and Merrill Lynch, government takeovers of the mortgage companies Fannie Mae and Freddie Mac and the insurer AIG, and the bankruptcy of Lehman Brothers.

Senior bankers in America predicted that more financial institutions would collapse.

William Smith, the president of Smith Asset Management, in New York, said: "You're talking about the largest failure in banking history, so there is going to be a negative reaction, right?

"What you are going to see is the strong stronger, and the weak are going to die off."

JP Morgan Chase is now the largest US bank by deposits. The company said that the transaction meant it would have 5,410 branches in 23 states, as well as the largest US credit card business. However, it gave warning that it would close many branches where Chase operations overlapped with WaMu.

JP Morgan's rescue saved the US banking industry having to dip into its insurance fund, which guarantees deposits up to $100,000 (pounds 54,300) for every saver - more generous than the British scheme, which promises to secure pounds 35,000.

WaMu has its roots in a savings association created to help Seattle residents rebuild after the city suffered a catastrophic fire in 1889.

Appendix 11

Business World (Digest)
September 29, 2008 Monday

WaMu files for bankruptcy in Delaware; WaMu Bankruptcy

HIGHLIGHT: Washington Mutual has filed a petition for Chapter 11 bankruptcy protection from creditors in a U.S. bankruptcy court in Delaware.

Washington Mutual has filed a petition for Chapter 11 bankruptcy protection from creditors in a U.S. bankruptcy court in Delaware.

In the voluntary petition filed at the weekend, the company listed assets of USD 32.9 billion, and debts of USD 8.2 billion, putting it in the top 10 largest U.S. bankruptcy cases ever filed.

Bank of New York Mellon, as a trustee for debtholders, was listed as the company's largest creditor.

According to the petition, Washington Mutual is being represented by New York law firm Weil Gotshal and Manges, which also represents Lehman Brothers Holdings Inc in its Chapter 11 case. Its subsidiary, WMI Investment Corp, also filed for bankruptcy protection, Washington Mutual said in a statement. The bankruptcy filing is a procedural step, as Washington Mutual was closed by the U.S. government this week in the largest U.S. bank failure in history. Its banking assets were sold to JPMorgan Chase & Co for USD 1.9 billion. Copyright: Thomson Financial

WaMu Case Suggestions for the Instructor

This case was designed to be used in any class where bank management and operations are discussed. This could include a class on bank management, money and banking, or financial markets and institutions.

Having readings or discussion on the composition of the bank balance sheet and basic bank functions in terms of asset transformation would be beneficial before assigning the case. In the class this case was developed for, the instructor covered that material plus some basic examples of asset management, liability management, and liquidity management prior to the case. However, these topics are also addressed in the case for students to refer to. Additionally, as the financial crisis becomes more distant, some discussion of the lending practices of the time and the lending practices of the time may be beneficial.

The case has been used six semesters (once per year) in a Money & Banking class. The first couple of semesters, it was covered in class with more involvement by the instructor. After some editing and adding additional information like the accompanying Excel sheet with period-to-period changes and common-size information, the case has been assigned as an out-of-class assignment and students have been able to complete the case satisfactorily.

<u>WaMu Case Answers</u>

1) Most of WaMu's liabilities are interest bearing and non-interest-bearing deposits. This means that a large portion of their short-term liabilities are in accounts covered by the FDIC. The remaining funds, about 40% of the 2007 balances, come from liabilities that are not covered by the FDIC and some, particularly Fed Funds and repos, that are more subject to availability risk. Their source of funds from Fed Funds and repos falls to virtually nothing with Other Borrowings declining substantially in terms of the dollar amount. Because they are not insured, these three types of funds are sensitive to the perceived risk of the institution. About 7.5% of their funding comes from equity at 12/31/2007. The dollar amount of equity increases around $1,500 through the combination of an increase of around $10,000 in common stock and a decrease of around $8,000 in retained earnings. This increase does not offset the loss in liabilities and coincides with an overall reduction in the balance sheet.

   Most assets are in loans held in portfolio. While, on the asset side, there are many accounts that decrease, the most noticeable decrease is in their loan portfolio. Not only do the loans held in portfolio fall by about $5,000, but the allowance for loan losses also increases by almost $6,000 or an almost 229% increase.

2) Most of the income on the income statement comes from interest income. The amount of noninterest income is less than a third of interest income and comes from fees and loan servicing. Total interest expense is more than non-interest expense for the six months ending 6/30/2007 and is substantially more for the six months ending 6/30/2008. The biggest change is in net interest income mostly due to a 1,455% increase in provision for

loan losses from $606 at 6/30/2007 to $9,423 at 6/30/2008. This is related to the rapid increase in the Allowance for Loan Loss Account on the balance sheet. This leads to an overall downturn in Net Income from $1,614 at 6/30/2007 to -$4,466 at 6/30/2008.

3) In the International Herald Tribune article, they note that WaMu received an infusion of capital from TPG, a private equity firm, and that the equity was in the form of common and preferred stock. This would explain the increase in the Capital Surplus account from 12/31/2007 to 6/30/2008. The article also mentions losses in its lending portfolio due to exposure to subprime and risky loan markets in areas such as Florida and California. The type of lending they had been pursuing, option ARMs, is also a particularly risky type of mortgage. The New York Post article pegs the capital infusion from TPG and others at $7 billion. The announcement initially buoyed WaMu's stock but it fell 10% the day following the announcement. The general sentiment that WaMu's position would continue to worsen with continued loan losses. The Daily Deal article announced a change in CEO at WaMu. In the article, it notes WaMu shares have fallen 80% in the last year. In response to the announcement, WaMu shares increased 0.1%.

4) As of 6/30/2008, WaMu is in worse shape than the year prior. Their loan losses are mounting, eating away at equity, and decreasing the value of their assets. To this point, their main source of funding, deposits, have not been too adversely affected. In fact, because of the capital injection they received, they are well above the capital ratios required by regulators and those imposed by themselves. So, at this point, they have survived the storm so far. They have experienced deterioration of their financial position, but they are not at the point of collapse. While we may not be happy with them as investors, there is a chance for their survival and possible redemption.

5) The Globe and Mail article mentions further loan losses and declines in the stock price. The article cites a $3.33 billion loss in the second quarter and that loan losses through 2011 are estimated to be $19 billion. It also noted that new capital raised would be very costly due to WaMu's worsening financial condition. As evidence of this, it quotes the yields on notes maturing in 2017 at 18.08%. Additionally, WaMu is now under additional regulatory oversight by the OTS.

   The 9-16-08 Washington Post article notes that S&P has downgraded WaMu's bonds to junk status and that its stock price is down 95% off of its 52-week high. There is also a concern that the FDIC does not have the ability to cover WaMu's deposits if the bank fails (which would be the largest bank failure in U.S. history). On the other hand, the FDIC and others think the FDIC can absorb the blow. The article also reveals that one of the instruments that got WaMu in trouble is a loan called an "option ARM".

   The OTS Fact Sheet provides a lot of data on WaMu's decline. Importantly, it points out that WaMu lost $16.7 in deposits after downgrades of WaMu's securities. It also notes that of WaMu's loans, 58% of them are option ARM or subprime loans. In other words, their loan portfolio is extremely risky. The Fact Sheet notes a change in strategy since 2006 where the bank has gotten out of the option ARM and subprime loan origination business.

This deposit outflow killed the bank. Based on their balances from 6/30/2008, they do not have enough liquid assets to cover these withdrawals. In addition, it is unlikely they could raise the funds (via Fed Funds or Repos) to cover the withdrawals due to their weak financial standing. In the end, the fear of their imminent collapse became a self-fulfilling prophecy.