WASHINGTON MUTUAL, INC
Form 10-K/A
May 22, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A
Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007

Commission File Number 1-14667

WASHINGTON MUTUAL, INC.

(Exact name of registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	**91-1653725** (I.R.S. Employer Identification Number)
1301 Second Avenue, Seattle, Washington (Address of principal executive offices)	**98101** (Zip Code)

Registrant's telephone number, including area code: **(206) 461-2000**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock	New York Stock Exchange
Depositary Shares each representing a 1/40,000th interest in a share of Series K Perpetual Preferred Non-Cumulative Floating Rate Stock	New York Stock Exchange
7.75% Series R Non-Cumulative Perpetual Convertible Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Litigation Tracking Warrants	NASDAQ

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes ý No o.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No ý.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý.

The aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2007, based on the closing sale price as reported on the New York Stock Exchange:

Common Stock $36,953,361,076[1]

[1] Does not include any value attributable to 6,000,000 shares held in escrow.

The number of shares outstanding of the issuer's classes of common stock as of January 31, 2008:

Common Stock 882,557,330[2]

[2] Includes 6,000,000 shares held in escrow.

Documents Incorporated by Reference

Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held April 15, 2008, are incorporated by reference into Part III.

WASHINGTON MUTUAL, INC.
2007 ANNUAL REPORT ON FORM 10-K/A
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Explanatory Note

Washington Mutual, Inc. ("Washington Mutual" or the "Company") is filing this Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2007 originally filed on February 29, 2008 ("Original Filing") to include additional disclosures to certain information presented in Parts II and III. Such additional disclosures have no effect on previously reported consolidated financial statements and notes to consolidated financial statements.

This Amendment No. 1 on Form 10-K/A amends the Original Filing as follows:

Part II, Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) to include in the Credit Risk Management section the five-year table of changes in the allowance for loan losses and the related disclosure of factors considered in determining the changes to the yearly allowance during the five-year period (pages 51 and 52). The Company had previously included and continues to include the five-year table of changes in the allowance for loan losses in Note 6 "Loans and Allowance for Loan Losses" to the Consolidated Financial Statements.

Part II, Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) to include in the Credit Risk Management section additional disclosure in connection with the allocated allowance for loan losses table regarding changes in the allocated allowance for the home loans portfolio and the subprime mortgage channel portfolio (pages 54 and 55).

Part III, Item 11 (Executive Compensation) to furnish the Item 11 disclosures contained in the Company's definitive proxy statement issued in conjunction with the Company's Annual Meeting of Shareholders held on April 15, 2008 (the "Annual Proxy Statement") (pages 81 to 137), which disclosures were incorporated in the Original Filing by reference to the Annual Proxy Statement, and to add the following disclosures concerning the design of the Company's 2008 bonus plan (beginning after the first sentence of paragraph 1 on page 92): "In selecting and defining the net operating profit performance measure for 2008, a period when the Company was expecting to experience significantly elevated loan loss provision and foreclosed asset expense from its single-family residential mortgage loan portfolio, the Committee was focused on sustaining and growing the Company's top-line revenues and controlling other expenses. Sustaining and growing top-line revenues and controlling other expenses were seen as important to achieving the following objectives: (a) enabling the Company to return to longer-range earnings expectations after these elevated credit costs subside, and (b) helping ensure that the fundamental drivers of the Company's long-term franchise value would not be materially diminished during the period of elevated credit costs in its mortgage loan portfolios. The Committee believed that these objectives would provide a foundation for restoring shareholder value."

Except for the foregoing additional Item 11 disclosures, revised page cross-references and including a list of peer companies on page 96 that was included as Appendix A to the Annual Proxy Statement, the Item 11 disclosures from the Annual Proxy Statement are repeated verbatim and, together with the foregoing additional Item 11 disclosures and list of peer companies, speak as of the date of the Annual Proxy Statement. Except for Item 7 of Part II and Item 11 of Part III , no other information in the Original Filing is being amended by this Amendment. This Amendment continues to speak as of the date of the Original Filing and the Company has not updated the disclosure in this Amendment to reflect any events which occurred at a date subsequent to the Original Filing.

PART II

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Controls and Procedures

Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or furnishes under the Securities Exchange Act of 1934.

Management reviews and evaluates the design and effectiveness of the Company's disclosure controls and procedures on an ongoing basis, which may result in the discovery of deficiencies, and improves its controls and procedures over time, correcting any deficiencies, as needed, that may have been discovered.

Changes in Internal Control Over Financial Reporting

Management reviews and evaluates the design and effectiveness of the Company's internal control over financial reporting on an ongoing basis, which may result in the discovery of deficiencies, some of which may be significant. Management changes its internal control over financial reporting as needed to maintain its effectiveness, correcting any deficiencies, as needed, in order to ensure the continued effectiveness of the Company's internal control over financial reporting. There have not been any changes in the Company's internal control over financial reporting during the fourth quarter of 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. For management's assessment of the Company's internal control over financial reporting, refer to Management's Report on Internal Control Over Financial Reporting on page 98.

Overview

Washington Mutual, through its subsidiaries, is one of the nation's leading consumer and small business banks. At December 31, 2007, Washington Mutual and its subsidiaries had assets of $328 billion. The Company has a history dating back to 1889 and its subsidiary banks currently operate nearly 2,500 consumer and small business banking stores throughout the nation. When we refer to "the Company," "we," "our" and "us" in this Annual Report on Form 10-K, we mean Washington Mutual, Inc. and subsidiaries. When we refer to "the Parent," we mean Washington Mutual, Inc.

The Company's sources of revenue are net interest income and noninterest income. Net interest income is generated by interest received from loans, investment securities and other interest-earning assets, less rates paid on deposits and borrowings. The primary sources of noninterest income are revenue from loan sales and servicing and fees from financial services provided to customers. A summary of the Company's key financial results are presented below:

The Company recorded a net loss for 2007 of $67 million, or $0.12 per diluted share, compared with net income of $3.56 billion, or $3.64 per diluted share, in 2006. The decline was primarily the result of significant credit deterioration in the Company's single-family residential mortgage loan portfolio and significant disruptions in the capital markets, including a sudden and severe contraction in secondary mortgage market liquidity for nonconforming residential loan products. These conditions also

contributed to the impairment of all goodwill associated with the Company's Home Loans business near the end of 2007.

Reflecting the significant credit deterioration, the Company recorded a provision for loan losses of $3.11 billion in 2007, an increase of $2.29 billion from 2006 and about twice the level of 2007 net charge-offs, which totaled $1.62 billion. Adverse trends in key housing market indicators, including growing inventories of unsold homes, rising foreclosure rates and a significant contraction in the availability of credit for nonconforming mortgage products continued to deteriorate throughout 2007 and exerted significant downward pressure on home prices, particularly in areas of the country in which the Company's lending activities have been concentrated. Nationwide sales volume of existing homes in December 2007 was 22% lower than in December 2006, leading to a supply of unsold homes of approximately 9.7 months, a 47% increase from December 2006, while the national median sales price for existing homes declined by 7% between those same periods. Housing market weakness was also evident from the change in the national volume of foreclosure filings, which increased by 75% in 2007 compared with 2006. With the downturn in the housing market, single-family residential mortgage delinquency levels have increased substantially and loss severity rates have grown significantly. These conditions are reflected in the Company's nonperforming assets to total assets ratio, which increased from 0.80% at December 31, 2006 to 2.17% at December 31, 2007. Net mortgage loan charge-offs as a percentage of the average balance of the real estate loan portfolio increased from 0.09% in 2006 to 0.55% in 2007, and on an annualized basis, from 0.14% in the fourth quarter of 2006 to 1.08% in the fourth quarter of 2007, reflecting the accelerating pace of deterioration in the credit quality of the mortgage loan portfolio. The increase in loss severity rates was particularly evident in the subprime mortgage channel and home equity loans and lines of credit portfolios. With early indicators in 2008 suggesting that the housing market is continuing to deteriorate, the Company expects that it will experience significantly higher credit costs throughout its single-family residential mortgage portfolios.

Net credit card charge-offs as a percentage of the average balance of the credit card portfolio were 3.08% in 2006 and 3.69% in 2007, reflecting a gradual downturn in credit quality as the U.S. economy softened. The national unemployment rate, which held steady in a range of 4.4% to 4.7% for most of 2007, increased to 4.9% in January 2008, while average net job growth for the three months ending January 31, 2008 was 42,000, compared with 121,000 for the three months ending January 31, 2007. The Company expects net credit card charge-off rates will continue to rise if the economy is pressured further by higher unemployment levels and sluggish job growth.

Noninterest income was $6.04 billion in 2007, compared with $6.38 billion in 2006. Deteriorating credit conditions also caused significant disruptions in the secondary mortgage market, which adversely affected the Company's noninterest income results. Gain from home mortgage loans and originated mortgage-backed securities, net of hedging and risk management instruments, totaled $59 million in 2007, compared with $735 million in 2006. Credit quality concerns created uncertainty in the market for subprime mortgage products during the first half of 2007. Those concerns intensified during the second half of the year and spread into the broader secondary market, resulting in a severe contraction of secondary market liquidity as investors avoided purchasing all mortgage products backed by nonconforming loan collateral. Because of this disruption, the Company transferred approximately $17 billion of real estate loans to its loan portfolio in the third quarter of 2007, representing substantially all of the Company's nonconforming loans that had been designated as held for sale. Illiquid secondary market conditions also affected the valuations of the Company's trading assets, which are primarily comprised of interests retained from mortgage loan and credit card securitizations. Widening credit spreads on these retained interests were primarily responsible for the loss on trading assets of $673 million in 2007, compared with a loss of $154 million in 2006. The Company also recognized other-than-temporary impairment losses of $375 million in the available-for-sale securities portfolio during the second half of 2007 on certain mortgage-backed securities.

Partially offsetting the losses in noninterest income were gains from mortgage servicing rights ("MSR") valuation and risk management of $205 million in 2007, compared with a loss of $393 million in 2006, as gains from the Company's MSR risk management instruments outpaced the decline in MSR fair value. While lower mortgage interest rates during the latter part of 2007 increased expected loan prepayment speeds, their effect on the MSR value was softened by the weakening housing market and the severe contraction in home mortgage credit availability, both of which significantly reduced home loan refinancing volume.

Noninterest expense totaled $10.60 billion in 2007, compared with $8.81 billion in 2006. The unprecedented challenges in the mortgage and credit markets during 2007 also had a significant effect on the Company's noninterest expense results. Noninterest expense in 2007 includes the fourth quarter effects from a $1.78 billion pre-tax impairment loss related to all goodwill associated with the Home Loans business. This non-cash charge did not affect the Company's tangible equity or regulatory capital ratios, or its liquidity position. With the fundamental shift in the mortgage market from credit disruptions and the expectation of a prolonged period of secondary mortgage market illiquidity, the Company took actions in the fourth quarter of 2007 to resize its home loans business in anticipation of continued declines in loan volume within the home mortgage industry, and to accelerate the direction of the home loans business to mortgage lending conducted through the Company's retail banking stores and other retail distribution channels. Among the actions taken by the Company were:

- Discontinuing all remaining lending through the subprime mortgage channel;
- Initiating the closure of WaMu Capital Corp., the Company's institutional broker-dealer business;
- Winding-down the Company's mortgage banker finance warehouse lending operations;
- Eliminating approximately 2,600 positions in the Home Loans business and approximately 550 corporate and other support positions; and
- Closing various home loan centers, sales offices, and home loan processing and call centers.

The Company recorded $143 million of additional noninterest expense in the fourth quarter of 2007 as a result of these actions, which are expected to generate approximately $500 million of expense savings during 2008.

Net interest income on a taxable-equivalent basis was $8.19 billion in 2007, compared with $8.13 billion in 2006. The increase was due to the expansion of the net interest margin, which increased, on a taxable-equivalent basis, from 2.60% in 2006 to 2.86% in 2007. The increase in the margin was primarily due to increases in the yields of mortgage loan products tied to short-term interest rate indices and the sales of lower-yielding mortgage loans. With the increasing deterioration in the housing market and the general softening of the economy, the Federal Reserve reduced the target Federal Funds rate by 100 basis points during the second half of 2007, and lowered this benchmark rate by another 125 basis points in January 2008, bringing the target rate down to 3.00%. As the Company's wholesale borrowing rates are usually correlated with interest rate policy changes made by the Federal Reserve and reprice to current market levels faster than most of the Company's interest-earning assets, the actions taken by the Fed are expected to further expand the margin in 2008.

To bolster its capital levels and liquidity position, the Company issued a total of $3.9 billion of Tier 1 capital in the fourth quarter of 2007, comprised of $2.9 billion, net, of noncumulative, perpetual convertible preferred stock issued by the Parent and $1 billion of noncumulative, perpetual preferred shares issued by Washington Mutual Preferred Funding LLC, an indirect subsidiary of Washington Mutual Bank. Additionally, commencing in the first quarter of 2008, the Company reduced its quarterly cash dividend rate on the Company's common stock to 15 cents per share. At December 31, 2007, the Company's estimated total risk-based capital to total risk-weighted assets ratio was 12.34% and its

estimated Tier 1 capital to average total assets ratio was 6.84%, exceeding the minimum regulatory guidelines of 8% and 4%, respectively, while the Company's tangible equity to total tangible assets ratio was 6.67%, well above its established target of 5.50%.

Critical Accounting Estimates

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States of America ("GAAP") requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the financial statements. Various elements of the Company's accounting policies, by their nature, involve the application of highly sensitive and judgmental estimates and assumptions. Some of these policies and estimates relate to matters that are highly complex and contain inherent uncertainties. It is possible that, in some instances, different estimates and assumptions could reasonably have been made and used by management, instead of those the Company applied, which might have produced different results that could have had a material effect on the financial statements.

The Company has identified four accounting estimates that, due to the judgments and assumptions inherent in those estimates, and the potential sensitivity of its financial statements to those judgments and assumptions, are critical to an understanding of its financial statements. These estimates are: the fair value of certain financial instruments and other assets; the allowance for loan losses and contingent credit risk liabilities; other-than-temporary impairment losses on available-for-sale securities; and the determination of whether a derivative qualifies for hedge accounting.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of the Company's Board of Directors. The Company believes that the judgments, estimates and assumptions used in the preparation of its financial statements are appropriate given the facts and circumstances as of December 31, 2007. The nature of these judgments, estimates and assumptions are described in greater detail in subsequent sections of Management's Discussion and Analysis and in Note 1 to the Consolidated Financial Statements "Summary of Significant Accounting Policies."

The discussion below presents information about the nature of the Company's critical accounting estimates:

Fair Value of Certain Financial Instruments and Other Assets

A portion of the Company's assets are carried at fair value, including: mortgage servicing rights, trading assets including certain retained interests from securitization activities, available-for-sale securities and derivatives. In addition, loans held for sale are recorded at the lower of cost or fair value. Changes in fair value of those instruments that qualify as hedged items under fair value hedge accounting are recognized in earnings and offset the changes in fair value of derivatives used as hedge accounting instruments.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Generally, for assets that are reported at fair value, the Company uses quoted market prices or internal valuation models to estimate their fair value. These models incorporate inputs such as forward yield curves, loan prepayment assumptions, market volatilities and pricing spreads utilizing market-based inputs where readily available. The degree of management judgment involved in estimating the fair value of a financial instrument or other asset is dependent upon the availability of quoted market prices or observable market value inputs. For financial instruments that are actively traded in the marketplace or whose values are based on readily available market value data, little judgment is necessary when estimating the instrument's fair value. When observable market prices and data are not readily

available, significant management judgment often is necessary to estimate fair value. In those cases, different assumptions could result in significant changes in valuation.

During the latter half of 2007, deteriorating credit conditions caused significant disruptions in the secondary mortgage market. Credit quality concerns prompted market participants to avoid purchasing mortgage investment products backed by nonconforming loan collateral. As market activity slowed, the availability of observable market prices was reduced. Accordingly, there was less market data available for use by management in the judgments applied to key valuation inputs.

The following financial instruments and other assets require the Company's most complex judgments and assumptions when estimating fair value:

Mortgage Servicing Rights and Certain Other Retained Interests in Securitizations

In June 2007, the Company implemented a model that is based on an option-adjusted spread ("OAS") valuation methodology to estimate the fair value of substantially all of its MSR asset. The model projects cash flows over multiple interest rate scenarios and discounts these cash flows using risk-adjusted discount rates. Additionally, an independent broker estimate of the fair values of the mortgage servicing rights is obtained quarterly along with other market-based evidence. Management uses this information together with its OAS valuation methodology to estimate the fair value of the MSR. Models used to value MSR assets, including those employing an OAS valuation methodology, are highly sensitive to changes in certain assumptions. Different expected prepayment speeds, in particular, can result in substantial changes in the estimated fair value of MSR. If actual prepayment experience differs materially from the expected prepayment speeds used in the Company's model, this difference may result in a material change in MSR fair value.

Changes in MSR value are reported in the Consolidated Statements of Income under the noninterest income caption "Revenue from sales and servicing of home mortgage loans." Additional discussion regarding the estimation of MSR fair value, including limitations to the MSR fair value measurement process, are described in the subsequent section of Management's Discussion and Analysis "Earnings Performance from Continuing Operations." Key economic assumptions and the sensitivity of MSR fair value to immediate changes in those assumptions are described in Note 8 to the Consolidated Financial Statements "Mortgage Banking Activities."

For other retained interests in securitization activities (such as interest-only strips and residual interests in mortgage and credit card securitizations), the discounted cash flow model used in estimating fair value utilizes projections of expected cash flows that are greatly influenced by expected prepayment speeds and, in some cases, expected net credit losses or finance charges related to the securitized assets. Key economic assumptions and the sensitivity of retained interests fair value to immediate changes in those assumptions are described in Note 7 to the Consolidated Financial Statements "Securitizations." Changes in those and other assumptions used could have a significant effect on the valuation of these retained interests. Changes in the value of other retained interests in securitization activities are reported in the Consolidated Statements of Income under the noninterest income caption "Loss on trading assets" and in the Consolidated Statements of Financial Condition as "Trading assets."

Loans held for sale

The fair value of loans designated as held-for-sale is generally based on observable market prices of securities that have loan collateral or interests in loans that are similar to the held-for-sale loans or whole loan sale prices if formally committed. If market prices are not readily available, fair value is based on a discounted cash flow model, which considers expected prepayment factors and the degree of credit risk associated with the loans and the estimated effects of changes in market interest rates relative to the loans' interest rates. When the estimated fair value of loans held for sale is lower than

their cost, including adjustments to cost if the loans were in a fair value hedge relationship under Financial Accounting Standards Board ("FASB") Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended ("Statement No. 133"), a valuation adjustment that accounts for this difference is reported in the Consolidated Statements of Income as a component within the noninterest income caption "Revenue from sales and servicing of home mortgage loans" for home loans. Valuation adjustments for consumer loans held for sale are recorded under the noninterest income caption "Revenue from sales and servicing of consumer loans." Valuation adjustments for multi-family and commercial real estate loans held for sale are recorded under the noninterest income caption "Other income."

Fair Value of Reporting Units and Goodwill Impairment

Under FASB Statement No. 142, *Goodwill and Other Intangible Assets*, goodwill must be allocated to reporting units and tested for impairment. The Company tests goodwill for impairment at least annually or more frequently if events or circumstances, such as adverse changes in the business, indicate that there may be justification for conducting an interim test. Impairment testing is performed at the reporting unit level (which is the same level as the Company's four major operating segments identified in Note 26 to the Consolidated Financial Statements "Operating Segments"). The first part of the test is a comparison, at the reporting unit level, of the fair value of each reporting unit to its carrying value, including goodwill. If the fair value is less than the carrying value, then the second part of the test is needed to measure the amount of potential goodwill impairment. The implied fair value of the reporting unit goodwill is calculated and compared with the actual carrying value of goodwill recorded within the reporting unit. If the carrying value of reporting unit goodwill exceeds the implied fair value of that goodwill, then the Company would recognize an impairment loss for the amount of the difference, which would be recorded as a charge against net income.

The fair value of the reporting units are determined primarily using discounted cash flow models based on each reporting unit's internal forecasts. In addition, analysis using market-based trading and transaction multiples, where available, is used to assess the reasonableness of the valuations derived from the discounted cash flow models.

For additional information regarding the carrying values of goodwill by operating segment, see Note 9 to the Consolidated Financial Statements "Goodwill and Other Intangible Assets."

Allowance for Loan Losses and Contingent Credit Risk Liabilities

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of incurred credit losses inherent in the Company's loan portfolio as of the balance sheet date. Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses in future periods.

The estimate of the allowance is based on a variety of factors, including past loan loss experience, the current credit profile of borrowers, adverse situations that have occurred that may affect a borrower's ability to meet his financial obligations, the estimated value of underlying collateral, general economic conditions, and the impact that changes in interest rates and unemployment levels have on a borrower's ability to repay adjustable-rate loans.

The Company allocates a portion of the allowance to the homogeneous loan portfolios and estimates this allocated portion using statistical estimation techniques. Loss estimation techniques used in statistical models are supplemented by qualitative information to assist in estimating the allocated allowance. When housing prices are volatile, lags in data collection and reporting increase the likelihood of adjustments being made to the allowance.

The Company also estimates an unallocated portion of the allowance that reflects management's assessment of various risk factors that are not fully captured by the statistical estimation techniques used to determine the allocated component of the allowance. The following factors are routinely and regularly reviewed in estimating the appropriateness of the unallocated allowance: national and local economic trends and conditions (such as gross domestic product and unemployment trends); market conditions (such as changes in housing prices); industry and borrower concentrations within portfolio segments (including concentrations by metropolitan statistical area); recent loan portfolio performance (such as changes in the levels and trends in delinquencies and impaired loans); trends in loan growth (including the velocity of change in loan growth); changes in underwriting criteria; and the regulatory and public policy environment.

The allowance for loan losses is reported in the Consolidated Statements of Financial Condition and the provision for loan losses is reported in the Consolidated Statements of Income.

The estimates and judgments are described in further detail in the subsequent section of Management's Discussion and Analysis "Credit Risk Management" and in Note 1 to the Consolidated Financial Statements "Summary of Significant Accounting Policies."

Contingent Credit Risk Liabilities

In the ordinary course of business, the Company sells loans to third parties and in certain circumstances, such as in the event of early or first payment default, retains credit risk exposure on those loans. The Company may also be required to repurchase sold loans when representations and warranties made by the Company in connection with those sales are breached. Under certain circumstances, such as when a loan sold to an investor and serviced by the Company fails to perform according to its contractual terms within the six months after its origination or upon written request of the investor, the Company will review the loan file to determine whether or not errors may have been made in the process of originating the loan. If errors are discovered and it is determined that such errors constitute a violation of a representation or warranty made to the investor in connection with the Company's sale of the loan, then the Company will be required to either repurchase the loan or indemnify the investor for losses sustained if the violation had a material adverse effect on the value of the loan.

Reserves are established for the Company's exposure to the potential repurchase or indemnification liabilities described above as such liabilities are initially recorded at fair value. Throughout the life of these repurchase or indemnification liabilities, the Company may learn of additional information that can affect the assessment of loss probability or the estimation of the amounts involved. Changes in these assessments can lead to significant changes in the recorded reserves. Repurchase and indemnification liabilities are recorded within other liabilities in the Consolidated Statements of Financial Condition, and losses are recorded in the Consolidated Statements of Income under the noninterest income caption "Revenue from sales and servicing of home mortgage loans."

Impairment of Securities

The Company monitors securities in its available-for-sale investment portfolio for impairment. Impairment may result from credit deterioration of the issuer, from changes in market rates relative to the interest rate of the instrument, or from changes in prepayment speeds. The Company considers many factors in determining whether the impairment is other than temporary, including but not limited to adverse changes in expected cash flows, the length of time the security has had a fair value less than the cost basis, the severity of the unrealized loss, the Company's intent and ability to hold the security for a period of time sufficient for a recovery in value and issuer-specific factors such as the issuer's financial condition, external credit ratings and general market conditions. The determination of

other-than-temporary impairment is a subjective process, requiring the use of judgments and assumptions in interpreting relevant market data. Other-than-temporary valuation losses on available-for-sale securities are reported in the Consolidated Statements of Income under the noninterest income caption "Loss on other available-for-sale securities." For additional information regarding the amortized cost, unrealized gains, unrealized losses, and fair value of securities, see Note 5 to the Consolidated Financial Statements "Available-for-Sale Securities."

Derivatives and Hedging Activities

The Company enters into derivative contracts to manage the various risks associated with certain assets, liabilities, or probable forecasted transactions. When the Company enters into derivative contracts, the derivative instrument is designated as: (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (a "fair value" hedge); (2) a hedge of the variability in expected future cash flows associated with an existing recognized asset or liability or a probable forecasted transaction (a "cash flow" hedge); or (3) held for other risk management purposes ("risk management derivatives").

All derivatives, whether designated in hedging relationships or not, are recorded at fair value as either assets or liabilities in the Consolidated Statements of Financial Condition. Changes in fair value of derivatives that are not in hedge accounting relationships (as in (3) above) are recorded in the Consolidated Statements of Income in the period in which the change in value occurs. Changes in the fair value of derivatives that are designated as cash flow hedges (as in (2) above), to the extent such hedges are deemed highly effective, are recorded as a separate component of accumulated other comprehensive income and reclassified into earnings when the earnings effect of the hedged cash flows is recognized. Changes in the fair value of derivatives in qualifying fair value hedge accounting relationships (as in (1) above) are recorded each period in earnings along with the change in fair value of the hedged item attributable to the risk being hedged.

The determination of whether a derivative qualifies for hedge accounting requires complex judgments about the application of Statement No. 133. Additionally, this Statement requires contemporaneous documentation of the Company's hedge relationships. Such documentation includes the nature of the risk being hedged, the identification of the hedged item, or the group of hedged items that share the risk exposure that is designated as being hedged, the selection of the instrument that will be used to hedge the identified risk, and the method used to assess the effectiveness of the hedge relationship. The assessment of hedge effectiveness requires calculations that utilize standard statistical methods of correlation that must support the determination that the hedging relationship is expected to be highly effective, during the period that the hedge is designated, in achieving offsetting changes in fair value or cash flows attributable to the hedged risk. If the Company's assessment of effectiveness is not considered to be adequate to achieve hedge accounting treatment, the derivative is treated as a free-standing risk management instrument.

Recently Issued Accounting Standards Not Yet Adopted

Refer to Note 1 to the Consolidated Financial Statements "Summary of Significant Accounting Policies."

Discontinued Operations

In December 2006, the Company exited the retail mutual fund management business and completed the sale of WM Advisors, Inc. WM Advisors provided investment management, distribution and shareholder services to the WM Group of Funds. This former subsidiary has been accounted for as a discontinued operation and, accordingly, its results of operations have been removed from the Company's results of continuing operations for the years ended December 31, 2006 and 2005 in the

Consolidated Statements of Income and in Note 26 to the Consolidated Financial Statements "Operating Segments."

Five-Year Summary of Selected Financial Data

	December 31,				
	2007	2006	2005	2004	2003
	(in millions, except per share amounts)				
Income Statement Data (for the year ended)					
Net interest income	$ 8,177	$ 8,121	$ 8,218	$ 7,411	$ 7,865
Provision for loan losses	3,107	816	316	209	42
Noninterest income	6,042	6,377	5,097	4,061	5,437
Noninterest expense	10,600	8,807	7,620	7,332	7,267
Net income (loss)	(67)	3,558	3,432	2,878	3,880
Basic earnings per common share:					
Income (loss) from continuing operations	(0.11)	3.27	3.80	2.84	4.17
Income from discontinued operations		0.47	0.04	0.50	0.12
Net income (loss)	(0.11)	3.74	3.84	3.34	4.29
Diluted earnings per common share:					
Income (loss) from continuing operations	(0.12)	3.18	3.69	2.77	4.09
Income from discontinued operations		0.46	0.04	0.49	0.12
Net income (loss)	(0.12)	3.64	3.73	3.26	4.21
Dividends declared per common share	2.21	2.06	1.90	1.74	1.40
Balance Sheet Data (at year end)					
Available-for-sale securities	$ 27,540	$ 24,978	$ 24,659	$ 19,219	$ 36,707
Loans held for sale	5,403	44,970	33,582	42,743	20,837
Loans held in portfolio	244,386	224,960	229,632	207,071	175,150
Mortgage servicing rights	6,278	6,193	8,041	5,906	6,354
Goodwill	7,287	9,050	8,298	6,196	6,196
Total assets	327,913	346,288	343,573	307,581	275,178
Total deposits	181,926	213,956	193,167	173,658	153,181
Securities sold under agreements to repurchase	4,148	11,953	15,532	15,944	28,333
Advances from Federal Home Loan Banks	63,852	44,297	68,771	70,074	48,330
Other borrowings	38,958	32,852	23,777	18,498	15,483
Minority interests	3,919	2,448	15	13	
Stockholders' equity	24,584	26,969	27,279	20,889	19,405
Supplemental Data					
Loan volume:					
Home loans:					
Adjustable-rate	$ 70,324	$ 110,914	$ 125,758	$ 128,263	$ 113,677
Fixed-rate	30,554	47,469	81,964	84,099	270,504
Total home loan volume	100,878	158,383	207,722	212,362	384,181
Total loan volume	151,502	205,085	260,770	266,397	431,906

Ratios and Other Supplemental Data

	Year Ended December 31,		
	2007	2006	2005
	(dollars in millions, except per share amounts)		
Profitability			
Return on average assets	(0.02)%	1.02%	1.05%
Return on average common equity	(0.42)	13.52	14.91
Net interest margin	2.85	2.60	2.79
Efficiency ratio[1][2]	74.55	60.75	57.23
Asset Quality (at year end)			
Nonaccrual loans	$ 6,123	$ 2,295	$ 1,686
Foreclosed assets	979	480	276
Total nonperforming assets[3]	7,102	2,775	1,962
Nonperforming assets[3] to total assets	2.17%	0.80%	0.57%
Allowance for loan losses	$ 2,571	$ 1,630	$ 1,695
Allowance as a percentage of total loans held in portfolio	1.05%	0.72%	0.74%
Credit Performance			
Net charge-offs	$ 1,623	$ 510	$ 244
Capital Adequacy (at year end)			
Stockholders' equity to total assets	7.50%	7.79%	7.94%
Tangible equity to total tangible assets[4]	6.67	6.04	5.62
Tier 1 capital to average total assets (leverage)[5]	6.84	6.35	5.83
Total risk-based capital to total risk-weighted assets[5]	12.34	11.77	10.80
Per Common Share Data			
Common shares outstanding at the end of period (in thousands)[6]	869,036	944,479	993,914
Common stock dividend payout ratio	N/M	55.08%	49.48%
Book value per common share (at year end)[7]	$ 24.55	$ 28.21	$ 27.61
Market prices:			
High	45.56	46.48	44.54
Low	13.07	41.47	36.92
Year end	13.61	45.49	43.50

N/M = Not meaningful

(1) Based on continuing operations.

(2) The efficiency ratio is defined as noninterest expense divided by total revenue (net interest income and noninterest income).

(3) Excludes nonaccrual loans held for sale.

(4) Excludes unrealized net gain/loss on available-for-sale securities and cash flow hedging instruments, goodwill and intangible assets (except MSR) and the impact from the adoption and application of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. Minority interests of $3.92 billion for December 31, 2007 and $2.45 billion for December 31, 2006 are included in the numerator.

(5) The capital ratios are estimated as if Washington Mutual, Inc. were a bank holding company subject to Federal Reserve Board capital requirements.

(6) Includes six million shares held in escrow.

(7) Excludes six million shares held in escrow.

Earnings Performance from Continuing Operations

Average balances, together with the total dollar amounts of interest income and expense related to such balances and the weighted average rates, were as follows:

	Year Ended December 31,								
	2007			2006			2005		
	Average Balance	Rate	Interest Income/ Expense	Average Balance	Rate	Interest Income/ Expense	Average Balance	Rate	Interest Income/ Expense
	(dollars in millions)								
Assets(1)									
Interest-earning assets(2):									
Federal funds sold and securities purchased under agreements to resell	$ 3,475	5.31%	$ 184	$ 4,718	5.20%	$ 245	$ 2,154	3.42%	$ 74
Trading assets	4,546	9.45	430	7,829	7.74	606	7,217	6.50	469
Available-for-sale securities(3):									
Mortgage-backed securities	19,647	5.49	1,078	21,534	5.41	1,165	16,359	4.81	786
Investment securities	7,334	5.13	377	5,992	4.92	295	4,494	4.71	212
Loans held for sale	20,421	6.81	1,391	27,791	6.50	1,807	44,847	5.34	2,394
Loans held in portfolio(4):									
Loans secured by real estate:									
Home loans(5)(6)	98,547	6.49	6,396	120,320	5.83	7,011	110,326	4.97	5,485
Home equity loans and lines of credit(6)	56,285	7.46	4,197	52,265	7.33	3,833	47,909	6.01	2,878
Subprime mortgage channel(7)	20,125	6.62	1,333	20,202	6.31	1,275	20,561	5.90	1,214
Home construction(8)	2,074	6.79	141	2,061	6.46	133	2,074	6.22	129
Multi-family	30,162	6.59	1,988	27,386	6.28	1,721	24,070	5.41	1,303
Other real estate	7,504	6.98	524	5,797	6.93	402	5,091	7.11	362
Total loans secured by real estate	214,697	6.79	14,579	228,031	6.30	14,375	210,031	5.41	11,371
Consumer:									
Credit card	10,113	10.55	1,067	8,733	11.19	977	2,082	11.96	249
Other	242	13.90	34	444	11.12	50	707	10.67	75
Commercial	1,916	8.10	155	1,886	6.94	131	2,614	5.04	132
Total loans held in portfolio	226,968	6.98	15,835	239,094	6.50	15,533	215,434	5.49	11,827
Other	4,275	4.53	194	5,220	4.90	256	4,324	3.65	158
Total interest-earning assets	286,666	6.80	19,489	312,178	6.38	19,907	294,829	5.40	15,920
Noninterest-earning assets:									
Mortgage servicing rights	6,616			7,667			6,597		
Goodwill	9,018			8,489			6,712		
Other assets	21,089			20,424			18,095		
Total assets	$ 323,389			$ 348,758			$ 326,233		
Liabilities(1)									
Interest-bearing liabilities:									
Deposits:									
Interest-bearing checking deposits	$ 29,261	2.42	709	$ 36,477	2.63	960	$ 46,524	1.95	906
Savings and money market deposits	56,459	3.27	1,846	48,866	2.96	1,446	42,555	1.76	750
Time deposits	82,551	4.91	4,055	84,106	4.59	3,857	62,175	3.33	2,072
Total interest-bearing deposits	168,271	3.93	6,610	169,449	3.70	6,263	151,254	2.46	3,728
Federal funds purchased and commercial paper	3,096	5.30	164	7,347	5.06	371	5,314	3.56	190
Securities sold under agreements to repurchase	8,330	5.32	443	15,257	5.12	781	15,365	3.40	523

	Year Ended December 31,								
Advances from Federal Home Loan Banks	37,144	5.28	1,963	56,619	4.99	2,828	68,713	3.46	2,377
Other	38,157	5.59	2,132	28,796	5.36	1,543	21,603	4.09	884
Total interest-bearing liabilities	254,998	4.44	11,312	277,468	4.25	11,786	262,249	2.94	7,702
Noninterest-bearing sources:									
Noninterest-bearing deposits	32,109			34,380			34,769		
Other liabilities	9,155			8,865			6,177		
Minority interests	2,933			1,639			14		
Stockholders' equity	24,194			26,406			23,024		
Total liabilities and stockholders' equity	$ 323,389			$ 348,758			$ 326,233		
Net interest spread and net interest income		2.36	$ 8,177		2.13	$ 8,121		2.46	$ 8,218
Impact of noninterest-bearing sources		0.49			0.47			0.33	
Net interest margin		2.85			2.60			2.79	
Taxable-Equivalent Basis									
Net interest margin and net interest income on a taxable-equivalent basis(9)		2.86	$ 8,191		2.60	$ 8,129		2.79	$ 8,225

(1) Average balances of assets and liabilities of acquired companies are calculated by dividing the stub period of the Company's ownership of those assets or liabilities by one year.

(2) Nonaccrual assets and related income, if any, are included in their respective categories.

(3) The average balance and yield are based on average amortized cost balances.

(4) Interest income for loans held in portfolio includes amortization of net deferred loan origination costs of $391 million, $463 million, and $402 million for the years ended December 31, 2007, 2006 and 2005.

(5) Capitalized interest recognized in earnings that resulted from negative amortization within the Option ARM portfolio totaled $1.42 billion, $1.07 billion, and $292 million for the years ended December 31, 2007, 2006 and 2005.

(6) Excludes home loans and home equity loans and lines of credit in the subprime mortgage channel.

(7) Represents mortgage loans purchased from recognized subprime lenders and mortgage loans originated under the Long Beach Mortgage name and held in the investment portfolio.

(8) Represents loans to builders for the purpose of financing the acquisition, development and construction of single-family residences for sale and construction loans made directly to the intended occupant of a single-family residence.

(9) Includes taxable-equivalent adjustments primarily related to tax-exempt income on U.S. states and political subdivisions securities and loans related to the Company's community lending and investment activities. The federal statutory tax rate was 35% for the periods presented.

The dollar amounts of interest income and interest expense fluctuate depending upon changes in interest rates and upon changes in the volume of interest-earning assets and interest-bearing liabilities. Changes attributable to (i) changes in volume (changes in average outstanding balances multiplied by the prior period's rate), (ii) changes in rate (changes in average interest rates multiplied by the prior period's volume), and (iii) changes in rate/volume (changes in rate multiplied by the change in volume)

which were allocated in proportion to the percentage changes in average volume and average rate and included in the relevant column below were as follows:

	2007 vs. 2006			2006 vs. 2005		
	Increase/(Decrease) Due to			Increase/(Decrease) Due to		
	Volume	Rate	Total Change	Volume	Rate	Total Change
	(in millions)					
Interest Income						
Federal funds sold and securities purchased under agreements to resell	$ (66)	$ 5	$ (61)	$ 119	$ 52	$ 171
Trading assets	(291)	115	(176)	42	95	137
Available-for-sale securities:						
Mortgage-backed securities	(104)	17	(87)	271	108	379
Investment securities	69	13	82	73	10	83
Loans held for sale	(499)	83	(416)	(1,036)	449	(587)
Loans held in portfolio:						
Loans secured by real estate:						
Home loans[1]	(1,357)	742	(615)	526	1,000	1,526
Home equity loans and lines of credit[1]	299	65	364	279	676	955
Subprime mortgage channel[2]	(5)	63	58	(22)	83	61
Home construction[3]	1	7	8	(1)	5	4
Multi-family	180	87	267	193	225	418
Other real estate	119	3	122	49	(9)	40
Total loans secured by real estate	(763)	967	204	1,024	1,980	3,004
Consumer:						
Credit card	148	(58)	90	745	(17)	728
Other	(26)	10	(16)	(29)	4	(25)
Commercial	2	22	24	(42)	41	(1)
Total loans held in portfolio	(639)	941	302	1,698	2,008	3,706
Other	(44)	(18)	(62)	37	61	98
Total interest income	(1,574)	1,156	(418)	1,204	2,783	3,987
Interest Expense						
Deposits:						
Interest-bearing checking deposits	(179)	(72)	(251)	(222)	276	54
Savings and money markets deposits	239	161	400	125	571	696
Time deposits	(73)	271	198	864	921	1,785
Total deposits	(13)	360	347	767	1,768	2,535
Federal funds purchased and commercial paper	(224)	17	(207)	87	94	181
Securities sold under agreements to repurchase	(368)	30	(338)	(4)	262	258
Advances from Federal Home Loan Banks	(1,021)	156	(865)	(471)	922	451
Other	520	69	589	342	317	659
Total interest expense	(1,106)	632	(474)	721	3,363	4,084
Net interest income	$ (468)	$ 524	$ 56	$ 483	$ (580)	$ (97)

(1)

Excludes home loans and home equity loans and lines of credit in the subprime mortgage channel.

(2) Represents mortgage loans purchased from recognized subprime lenders and mortgage loans originated under the Long Beach Mortgage name and held in the investment portfolio.

(3) Represents loans to builders for the purpose of financing the acquisition, development and construction of single-family residences for sale and construction loans made directly to the intended occupant of a single-family residence.

Net Interest Income

Net interest income and the net interest margin, both expressed on a taxable-equivalent basis, totaled $8.19 billion and 2.86% in 2007, compared with $8.13 billion and 2.60% in 2006. The increase in the net interest margin was primarily due to increases in the yields of mortgage loan products tied to short-term interest rate indices and the sales of lower-yielding mortgage loans, and a favorable change in the mix between deposits and comparatively higher cost borrowed funds. Deposits funded 70% of the interest-earning asset base during 2007, compared with 65% in 2006. A decline in average interest earning assets in 2007 partially offset the expansion of the margin, as the Company sought to deemphasize balance sheet growth during a time in which the yield curve was relatively flat or slightly inverted.

Noninterest Income

Noninterest income from continuing operations consisted of the following:

	Year Ended December 31,			Percentage Change	
	2007	2006	2005	2007/2006	2006/2005
	(in millions)				
Revenue from sales and servicing of home mortgage loans	$ 944	$ 768	$ 2,017	23%	(62)%
Revenue from sales and servicing of consumer loans	1,639	1,527	413	7	270
Depositor and other retail banking fees	2,893	2,567	2,193	13	17
Credit card fees	778	637	139	22	358
Securities fees and commissions	260	215	189	21	13
Insurance income	116	127	172	(8)	(26)
Loss on trading assets	(673)	(154)	(257)	336	(40)
Loss on other available-for-sale securities	(319)	(9)	(84)		(90)
Other income	404	699	315	(42)	122
Total noninterest income	$ 6,042	$ 6,377	$ 5,097	(5)	25

Revenue from sales and servicing of home mortgage loans

Revenue from sales and servicing of home mortgage loans, including the effects of derivative risk management instruments, consisted of the following:

	Year Ended December 31,			Percentage Change	
	2007	**2006**	**2005**	**2007/2006**	**2006/2005**
		(in millions)			
Revenue from sales and servicing of home mortgage loans:					
Sales activity:					
Gain from home mortgage loans and originated mortgage-backed securities[1]	$ 52	$ 626	$ 873	(92)%	(28)%
Revaluation gain from derivatives economically hedging loans held for sale	7	109	76	(93)	42
Gain from home mortgage loans and originated mortgage-backed securities, net of hedging and risk management instruments	59	735	949	(92)	(23)
Servicing activity:					
Home mortgage loan servicing revenue[2]	2,047	2,181	2,110	(6)	3
Change in MSR fair value due to payments on loans and other[3]	(1,363)	(1,654)		(18)	
Change in MSR fair value due to valuation inputs or assumptions[3]	(157)	299			
MSR valuation adjustments[4]			965		
Amortization of MSR			(2,170)		
Revaluation gain (loss) from derivatives economically hedging MSR	358	(636)	163		
Adjustment to MSR fair value for MSR sale		(157)			
Home mortgage loan servicing revenue, net of MSR valuation changes and derivative risk management instruments	885	33	1,068		(97)
Total revenue from sales and servicing of home mortgage loans	$ 944	$ 768	$ 2,017	23	(62)

(1) Originated mortgage-backed securities represent available-for-sale securities retained on the balance sheet subsequent to the securitization of mortgage loans that were originated by the Company.

(2) Includes contractually specified servicing fees (net of guarantee fees paid to housing government-sponsored enterprises, where applicable), late charges and loan pool expenses (the shortfall of the scheduled interest required to be remitted to investors and that which is collected from borrowers upon payoff).

(3) Line item descriptions reflect the impact of the adoption of Statement No. 156 on January 1, 2006. The retrospective application of this statement to prior periods is not permitted.

(4) Net of fair value hedge ineffectiveness as well as any impairment/reversal recognized on MSR that resulted from the application of the lower of cost or fair value accounting methodology in 2005.

The following table presents MSR valuation and the corresponding risk management derivative instruments and securities during the years ended December 31, 2007 and 2006:

	Year Ended December 31,	
	2007	2006
	(in millions)	
MSR Valuation and Risk Management:		
Change in MSR fair value due to valuation inputs or assumptions	$ (157)	$ 299
Gain (loss) on MSR risk management instruments:		
Revaluation gain (loss) from derivatives	358	(636)
Revaluation gain (loss) from certain trading securities	4	(55)
Loss from certain available-for-sale securities		(1)
Total gain (loss) on MSR risk management instruments	362	(692)
Total changes in MSR valuation and risk management	$ 205	$ (393)

The following tables reconcile the gains (losses) on investment securities that are designated as MSR risk management instruments to loss on trading assets and loss on other available-for-sale securities that are reported within noninterest income during the years ended December 31, 2007 and 2006:

	Year Ended December 31,	
	2007	2006
	(in millions)	
Gain (loss) on trading assets resulting from:		
MSR risk management instruments	$ 4	$ (55)
Other	(677)	(99)
Total loss on trading assets	$ (673)	$ (154)

	Year Ended December 31,	
	2007	2006
	(in millions)	
Loss on other available-for-sale securities resulting from:		
MSR risk management instruments	$	$ (1)
Other	(319)	(8)
Total loss on other available-for-sale securities	$ (319)	$ (9)

Gain from home mortgage loans and originated mortgage-backed securities, net of hedging and risk management instruments was $59 million in 2007, compared with $735 million in the prior year. Secondary market conditions for subprime mortgage loans rapidly deteriorated during the first half of 2007 in response to the weakening housing market. As credit risk concerns from rising subprime mortgage borrower defaults increased, credit spreads widened to reflect secondary market demands for higher risk premiums on subprime mortgage loans, which lowered the value of the loans to be sold. Credit concerns spread across the secondary market in the second half of 2007 as mortgage delinquencies and loss severities across all single-family residential borrower classes accelerated. This led to a severe contraction in risk tolerances among secondary market participants and resulted in an illiquid market for nonconforming home loans. With the absence of liquidity

for such loans, home loan sales volume totaled only $17.38 billion in the last half of 2007, a 69% decline from $56.58 billion for the same period in 2006. The Company transferred into its held for investment portfolio approximately

$15 billion of single-family residential loans in the third quarter of 2007, which were substantially comprised of nonconforming products that had initially been designated as held for sale prior to the rapid contraction in secondary market liquidity. A $139 million downward adjustment on the transferred loans was recorded based on the lower of cost or fair value, reflecting the wider secondary market credit spreads that accompanied the market disruption.

The fair value changes in home mortgage loans held for sale and the offsetting changes in the derivative instruments used as fair value hedges are recorded within gain from home mortgage loans when hedge accounting treatment is achieved. Home mortgage loans held for sale where hedge accounting treatment is not achieved are recorded at the lower of cost or fair value. This accounting method requires declines in the fair value of these loans, to the extent such value is below their cost basis, to be immediately recognized within gain from home mortgage loans, but any increases in the value of these loans that exceed their original cost basis may not be recorded until the loans are sold. However, all changes in the value of derivative instruments that are used to manage the interest rate risk of these loans must be recognized in earnings as those changes occur.

In March 2006, the FASB issued Statement No. 156, *Accounting for Servicing of Financial Assets*, which amends Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, permitting for the first time an entity to report classes of servicing assets at fair value at each reporting date and to record changes in fair value of such reported classes of servicing assets in earnings in the period in which the changes occur. The Company applied Statement No. 156 to its financial statements on January 1, 2006 and elected to measure its mortgage servicing assets at fair value. Upon electing the fair value method of accounting for its mortgage servicing assets, the Company discontinued the application of fair value hedge accounting. Accordingly, beginning in 2006, all derivatives held for MSR risk management are treated as economic hedges, with valuation changes recorded as revaluation gain (loss) from derivatives economically hedging MSR. Additionally, upon the change from the lower of cost or fair value accounting method to fair value accounting under Statement No. 156, the calculation of amortization and the assessment of impairment were discontinued and the MSR valuation allowance was written off against the recorded value of the MSR. Those measurements have been replaced by fair value adjustments that encompass market-driven valuation changes and the runoff in value that occurs as scheduled loan payments are made over time, which are each separately reported.

Home mortgage loan servicing revenue decreased by $134 million for the year ended December 31, 2007, compared with 2006. The decrease was largely the result of the sale of $2.53 billion of mortgage servicing rights in July 2006. The decline was more than offset by a decrease in the rate of MSR fair value changes from loan payments of $291 million between the same years, as actual payment rates on the servicing portfolio decreased in 2007 due to significantly lower levels of refinancing activity.

MSR valuation and risk management results were a gain of $205 million in 2007, compared with a loss of $393 million in 2006. Although mortgage interest rates at the end of 2007 were at similar levels to those that existed at the beginning of the year, more significant fluctuations occurred over the course of 2007, which led to a modest decrease in MSR value of $157 million for the year. The decrease in value occurred primarily during the second half of 2007, as mortgage rates generally declined during that period, resulting in higher expected prepayment speeds. However, the impact of lower interest rates on projected MSR prepayment speeds was mitigated by a smaller increase in expected prepayment rates, reflecting diminished opportunities for borrowers to refinance during a period when the housing market is weakening, underwriting standards across the mortgage banking industry have tightened and rates for nonconforming loan products are higher. The performance of the MSR risk management instruments was adversely affected by the flat-to-inverted slope of the yield curve in 2006, which had the effect of increasing hedging costs.

The value of the MSR asset is subject to prepayment risk. Future expected net cash flows from servicing a loan in the servicing portfolio will not be realized if the loan pays off earlier than expected. Moreover, since most loans within the servicing portfolio do not impose prepayment fees for early payoff, a corresponding economic benefit will not be received if the loan pays off earlier than expected. The fair value of the MSR is estimated from the present value of the future net cash flows the Company expects to receive from the servicing portfolio. Accordingly, prepayment risk subjects the MSR to potential declines in fair value. During the second quarter of 2007, the Company adopted an option-adjusted spread ("OAS") valuation methodology for estimating the fair value of substantially all of its MSR asset. This methodology projects MSR cash flows over multiple interest rate scenarios, and discounts those cash flows using risk-adjusted discount rates to arrive at an estimate of the fair value of the MSR asset. As the Company's OAS model was calibrated to the prior model's valuation results, the conversion to the new methodology did not result in a fair value adjustment to the Company's MSR asset upon its implementation.

All Other Noninterest Income Analysis

Revenue from sales and servicing of consumer loans increased $112 million for the year ended December 31, 2007, compared with 2006. While revenue from sales increased between the two periods as a result of a 50% increase in credit card securitization volume, revenue from servicing declined in 2007, when compared with 2006. This decline in servicing revenue was a result of realization of higher than originally estimated interest and fees charged on securitized loans and lower than originally estimated credit losses.

Depositor and other retail banking fees increased $326 million for the year ended December 31, 2007, compared with 2006, predominantly due to higher transaction fees and an increase in the number of noninterest-bearing checking accounts. The number of noninterest-bearing checking accounts at December 31, 2007 totaled approximately 11.0 million compared with approximately 9.6 million at December 31, 2006.

Credit card fees increased $141 million for the year ended December 31, 2007, compared with 2006, reflecting growth in the average balance of the credit card portfolio.

Securities fees and commissions increased $45 million for the year ended December 31, 2007, compared with 2006, due to an increase in the volume of mutual fund and annuity sales.

Loss on trading assets increased $519 million for the year ended December 31, 2007, compared with 2006. Similar to the way in which capital market disruptions affected the Company's mortgage banking results, the severe downturn in the housing market and rising levels of credit card delinquencies contributed to less favorable economic assumptions used to measure the value of trading assets retained from mortgage loan and credit card securitizations.

The Company recognizes impairment losses on available-for-sale securities through the income statement when it has concluded that a decrease in the fair value of a security is other than temporary. During the second half of 2007, the Company recognized charges totaling $375 million related to mortgage-backed securities where it determined that a decline in fair value below amortized cost represented an other-than-temporary condition.

The decrease in other income of $295 million for the year ended December 31, 2007, compared with 2006, primarily resulted from losses related to equity method investments and revaluation losses on derivatives held for risk management purposes. In addition, included in 2006 was a $149 million litigation award from the partial settlement of the Company's claim against the U.S. Government with regard to the Home Savings supervisory goodwill lawsuit.

Noninterest Expense

Noninterest expense from continuing operations consisted of the following:

	Year Ended December 31,			Percentage Change	
	2007	2006	2005	2007/2006	2006/2005
	(in millions)				
Compensation and benefits	$ 3,766	$ 3,937	$ 3,701	(4)%	6%
Occupancy and equipment	1,589	1,711	1,520	(7)	13
Telecommunications and outsourced information services	530	554	449	(4)	23
Depositor and other retail banking losses	262	229	226	14	2
Advertising and promotion	445	443	315		41
Professional fees	233	227	181	3	26
Postage	417	471	293	(12)	61
Foreclosed asset expense	309	117	75	164	56
Goodwill impairment charge	1,775				
Other expense	1,274	1,118	860	14	30
Total noninterest expense	$ 10,600	$ 8,807	$ 7,620	20	16

Noninterest expense in 2007 includes the fourth quarter effects from a $1.78 billion pre-tax impairment loss related to all goodwill associated with the Home Loans business. With the fundamental shift in the mortgage market from credit disruptions and the expectation of a prolonged period of secondary mortgage market illiquidity, the Company also recorded charges of $143 million in the fourth quarter to resize its Home Loans business and corporate support functions in anticipation of continued declines in home mortgage industry loan originations, and to accelerate the direction of its mortgage banking operations to home lending conducted through retail banking stores and other retail distribution channels. The charges consist of $58 million in employee termination benefits, $42 million in lease termination and other decommissioning costs, and $43 million of fixed asset write-downs.

The Company determined that the actions associated with the resizing of the Home Loans business represent restructuring activities. Accordingly, the resizing expenses described above included $98 million of restructuring charges that resulted from the discontinuation of subprime mortgage lending, the announced closure of WaMu Capital Corp., the wind-down of the Company's mortgage banker finance operations, and the closure of certain home loans production centers and back-office support functions. The restructuring charges are described further in Note 2 to the Consolidated Financial Statements "Restructuring Activities."

Compensation and benefits expense decreased $171 million, or 4%, from 2006, primarily due to lower home loan mortgage banking incentive compensation that resulted from the significant decline in home loan volume. The number of employees decreased from 49,824 employees at December 31, 2006 to 49,403 employees at December 31, 2007. Employee headcount was further reduced to 48,433 at January 31, 2008, reflecting the fourth quarter 2007 actions to resize the Company's Home Loans business and corporate support functions.

The decrease in occupancy and equipment expense during 2007 was primarily due to charges in 2006 of approximately $185 million related to the Company's productivity and efficiency initiatives, partially offset by charges in 2007 to resize the Company's Home Loans business and corporate support functions.

Depositor and other retail banking losses increased during 2007 predominantly due to an increase in the number of transaction accounts, resulting in an increase in loss levels for returned deposited items and overdrawn account losses.

Postage expense decreased during 2007 due to a decline in courier expense related to improved efficiency in the cash distribution process in the Company's retail banking operations.

The increase in foreclosed asset expense during 2007 was due to higher foreclosures reflecting the deterioration in the credit environment and further weakening in the housing market. The total number of foreclosed properties has increased while the values of those properties have generally declined.

The increase in other expense from 2006 was partly due to charges of $88 million for Visa related litigation liabilities recognized during 2007. The Company recognized charges of $38 million in the third quarter of 2007 related to its share of the American Express settlement of a covered litigation matter and $50 million in the fourth quarter of 2007 to accrue for a contingent obligation for certain unresolved disputes involving Visa and its members.

Income Taxes

For 2007, a tax provision of $376 million was recorded, compared with a tax provision of $1.66 billion for 2006. The tax provision recorded for 2007 was significantly impacted by the pre-tax goodwill impairment charge of $1.78 billion, of which approximately $1.3 billion is not deductible for income tax purposes. The effective tax rate for the tax benefit recorded on the goodwill impairment charge was 9.83%. Excluding the goodwill impairment charge, the effective tax rate for 2007 would have been 26.41%, compared with 34.73% in 2006. The reduction in the effective tax rate for 2007 (excluding the goodwill impairment charge) is mostly due to reduced income from continuing operations before income taxes.

Review of Financial Condition

Trading Assets

Trading assets consisted of the following:

	December 31,	
	2007	2006
	(in millions)	
Credit card retained interests	$ 1,838	$ 1,464
Mortgage-backed securities	854	2,880
U.S. Government and other debt securities	76	90
Total trading assets	$ 2,768	$ 4,434

The Company's trading assets are primarily comprised of financial instruments that are retained from securitization transactions. Credit card retained interests are mostly comprised of subordinated interests that consist of noninterest bearing beneficial interests. These retained interests are repaid after the related senior classes of securities, which are usually held by third party investors.

Trading assets at December 31, 2007 decreased $1.67 billion from December 31, 2006 predominantly due to a $1.85 billion decline in securities held by WaMu Capital Corp. ("WCC"), an indirect subsidiary of the Company. During December 2007, the Company announced its intention to close WCC, its institutional broker-dealer business, as part of restructuring its Home Loans business.

The following table presents trading assets, including mortgage-backed securities by asset type, by investment grade at December 31, 2007:

	AAA[1]	AA	A	BBB	Below Investment Grade	Total
	(in millions)					
Credit card retained interests	$	$ 34	$ 108	$ 284	$ 1,412	$ 1,838
Mortgage-backed securities:						
Agency	53					53
Prime	310	5	32	39	23	409
Alt-A	116	89	37	34	45	321
Subprime				2	20[2]	22
Commercial					49	49
Total mortgage-backed securities	479	94	69	75	137	854
U.S. Government and other debt securities	76					76
Total trading assets	$ 555	$ 128	$ 177	$ 359	$ 1,549	$ 2,768

(1) Includes securities guaranteed by the U.S. Government or U.S. Government sponsored agencies, which are not rated.

(2) Represents retained interest in subprime mortgage loan securitizations, including $5 million in residual interests.

Available-for-Sale Securities

Available-for-sale securities consisted of the following:

	December 31, 2007	December 31, 2006
	(in millions)	
Available-for-sale securities, total amortized cost of $27,789 and $25,073:		
Mortgage-backed securities	$ 19,249	$ 18,601
Investment securities	8,291	6,377
Total available-for-sale securities	$ 27,540	$ 24,978

The Company holds available-for-sale securities primarily for interest rate risk management and liquidity enhancement purposes. Accordingly, the portfolio is comprised primarily of highly-rated debt securities.

The fair value of available-for-sale mortgage-backed securities by asset type and investment grade at December 31, 2007 is presented in the following table:

	AAA[1]	AA	A	BBB	Below Investment Grade	Total
	(in millions)					
Mortgage-backed securities:						
Agency	$ 7,192	$	$	$	$	$ 7,192
Prime	3,801	540	161	73		4,575
Alt-A	600	175	68	74	23	940
Subprime	236	88	121	37	9	491
Commercial	6,015	17		10	9	6,051
Total mortgage-backed securities	$ 17,844	$ 820	$ 350	$ 194	$ 41	$ 19,249

(1) Includes securities guaranteed by the U.S. Government or U.S. Government sponsored agencies, which are not rated.

At December 31, 2007, available-for-sale investment securities were comprised primarily of U.S. Government-sponsored agency securities and securities issued by U.S. states and political subdivisions. Substantially all investment securities are investment grade.

Refer to Note 5 to the Consolidated Financial Statements "Available-for-Sale Securities" for additional information on securities, classified by security type.

Loans

Total loans consisted of the following:

	December 31,				
	2007	2006	2005	2004	2003
	(in millions)				
Loans held for sale	$ 5,403	$ 44,970	$ 33,582	$ 42,743	$ 20,837
Loans held in portfolio:					
Loans secured by real estate:					
Home loans[1]	$ 110,387	$ 99,479	$ 114,144	$ 109,950	$ 100,043
Home equity loans and lines of credit[1]	60,963	52,882	50,840	43,648	27,644
Subprime mortgage channel[2]:					
Home loans	16,092	18,725	21,146	19,184	12,973
Home equity loans and lines of credit	2,525	2,042	11	2	3
Home construction[3]	2,226	2,082	2,037	2,344	2,220
Multi-family[4]	31,754	30,161	25,601	22,282	20,324
Other real estate[5]	9,524	6,745	5,035	5,664	6,649
Total loans secured by real estate	233,471	212,116	218,814	203,074	169,856
Consumer:					
Credit card	8,831	10,861	8,043		
Other	205	276	638	792	1,028
Commercial	1,879	1,707	2,137	3,205	4,266

	December 31,				
Total loans held in portfolio[6]	$ 244,386	$ 224,960	$ 229,632	$ 207,071	$ 175,150

(1) Excludes home loans and home equity loans and lines of credit in the subprime mortgage channel.

(2) Represents mortgage loans purchased from recognized subprime lenders and mortgage loans originated under the Long Beach Mortgage name and held in the investment portfolio.

(3) Represents loans to builders for the purpose of financing the acquisition, development and construction of single-family residences for sale and construction loans made directly to the intended occupant of a single-family residence.

(4) Includes multi-family construction balances of $967 million, $740 million, $632 million, $333 million and $325 million at December 31, 2007, 2006, 2005, 2004 and 2003.

(5) Includes other commercial real estate construction balances of $812 million, $414 million, $208 million, $277 million and $382 million at December 31, 2007, 2006, 2005, 2004 and 2003.

(6) Includes net unamortized deferred loan costs of $1.45 billion, $1.88 billion, $1.96 billion, $1.87 billion and $1.55 billion at December 31, 2007, 2006, 2005, 2004 and 2003.

Due to the illiquid market, residential mortgage loans designated as held for sale at December 31, 2007 were largely limited to conforming loans eligible for purchase by the housing government-sponsored enterprises. The December 31, 2006 balance of loans held for sale included approximately $17.5 billion of medium-term adjustable-rate home loans which were transferred during the fourth quarter of 2006 from loans held in portfolio to loans held for sale. These loans were subsequently sold during the first quarter of 2007. In addition, as a result of the severe contraction in secondary market liquidity, the Company transferred approximately $17 billion of real estate loans to its loan portfolio during the third quarter of 2007, which represented substantially all of the Company's nonconforming loans that had been designated as held for sale prior to the market disruption.

Total home loans held in portfolio consisted of the following:

	December 31,	
	2007	**2006**
	(in millions)	
Home loans:		
Short-term adjustable-rate loans[1]:		
Option ARMs[2]	$ 58,870	$ 63,557
Other ARMs	9,551	6,791
Total short-term adjustable-rate loans	68,421	70,348
Medium-term adjustable-rate loans[3]	36,507	26,232
Fixed-rate loans	5,459	2,899
Home loans held in portfolio[4]	110,387	99,479
Subprime mortgage channel	16,092	18,725
Total home loans held in portfolio	$ 126,479	$ 118,204

(1) Short-term adjustable-rate loans reprice within one year.

(2) The total amount by which the unpaid principal balance of Option ARM loans exceeded their original principal amount was $1.73 billion and $888 million at December 31, 2007 and 2006.

(3) Medium-term adjustable-rate loans reprice after one year.

(4) Excludes home loans in the subprime mortgage channel.

The home loans held in portfolio balance at December 31, 2007 increased $8.28 billion from December 31, 2006. The increase was due primarily to the transfer of approximately $15 billion of nonconforming home loans previously designated as loans held for sale prior to the market disruption experienced during the third quarter of 2007. Partially offsetting this increase was a decrease in Option ARM loans, reflecting the slowdown in the housing market and an interest rate environment in which loan products with longer repricing frequencies are priced more favorably than short-term adjustable-rate loans.

The balance of home equity loans and lines of credit at December 31, 2007, excluding home equity loans and lines of credit in the subprime mortgage channel, increased 15% from December 31, 2006 primarily due to growth in lines of credit.

Home, multi-family and other commercial real estate construction loans and commercial business loans by maturity date were as follows:

	December 31, 2007			
	Due Within One Year	After One But Within Five Years	After Five Years	Total
	(in millions)			
Home construction[1]:				
Adjustable-rate	$ 1,021	$ 154	$ 217	$ 1,392
Fixed-rate	108	3	723	834
Multi-family construction:				
Adjustable-rate	248	413	11	672
Fixed-rate	148	31	116	295
Other commercial real estate construction:				
Adjustable-rate	313	476	1	790
Fixed-rate			22	22
Commercial business:				
Adjustable-rate	1,320	101	148	1,569
Fixed-rate	92	151	67	310
Total	$ 3,250	$ 1,329	$ 1,305	$ 5,884

(1) Includes $37 million of loans to builders and $2.19 billion of loans to the intended occupant of a single-family residence.

Deposits

Deposits consisted of the following:

	December 31,	
	2007	2006
	(in millions)	
Retail deposits:		
Checking deposits:		
Noninterest bearing	$ 23,476	$ 22,838
Interest bearing	25,713	32,723
Total checking deposits	49,189	55,561
Savings and money market deposits	44,987	41,943
Time deposits	49,410	46,821
Total retail deposits	143,586	144,325
Commercial business and other deposits	11,267	15,175
Brokered deposits:		
Consumer	18,089	22,299
Institutional	2,515	22,339
Custodial and escrow deposits	6,469	9,818
Total deposits	$ 181,926	$ 213,956

	December 31,	

Interest-bearing retail checking deposits decreased as customers shifted from Platinum checking accounts to time deposits and savings and money market deposits as a result of higher interest rates offered for these products.

Institutional brokered deposits decreased $19.82 billion or 89% from December 31, 2006, largely due to reduced funding needs as the Company reduced total assets approximately 10% during the first

half of 2007. During the second half of 2007, as a result of the illiquid capital markets, the Company retained nonconforming mortgage loan products in its portfolio. The increase in assets was funded with more readily available and lower cost funding sources such as advances from FHLBs. Advances from FHLBs increased from $44.30 billion at December 31, 2006 to $63.85 billion at December 31, 2007.

Transaction accounts (checking, savings and money market deposits) comprised 66% of retail deposits at December 31, 2007 and 68% at December 31, 2006. These products generally have the benefit of lower interest costs, compared with time deposits, and represent the core customer relationship that is maintained within the retail banking franchise. Average total deposits funded 70% of average total interest-earning assets for the year ended December 31, 2007, compared with 65% for the year ended December 31, 2006.

Operating Segments

The Company has four operating segments for the purpose of management reporting: the Retail Banking Group, the Card Services Group, the Commercial Group and the Home Loans Group. The Company's operating segments are defined by the products and services they offer. The Retail Banking Group, the Card Services Group and the Home Loans Group are consumer-oriented while the Commercial Group serves commercial customers. In addition, the category of Corporate Support/Treasury and Other includes the community lending and investment operations; the Treasury function, which manages the Company's interest rate risk, liquidity position and capital; the Corporate Support function, which provides facilities, legal, accounting and finance, human resources and technology services; and the Enterprise Risk Management function, which oversees the identification, measurement, monitoring, control and reporting of credit, market and operational risk.

The Company serves the needs of 19.8 million consumer households through its 2,257 retail banking stores, 233 lending stores and centers, 4,713 owned and branded ATMs, telephone call centers and online banking.

The principal activities of the **Retail Banking Group** include: (1) offering a comprehensive line of deposit and other retail banking products and services to consumers and small businesses; (2) holding the substantial majority of the Company's held for investment portfolios of home loans, home equity loans and home equity lines of credit (but not the Company's held for investment portfolios of home loans, home equity loans and home equity lines of credit made to higher risk borrowers through the subprime mortgage channel); (3) originating home equity loans and lines of credit; and (4) providing investment advisory and brokerage services, sales of annuities and other financial services.

Deposit products offered to consumers and small businesses include the Company's signature free checking and interest-bearing Platinum checking accounts, as well as other personal checking, savings, money market deposit and time deposit accounts. Many products are offered in retail banking stores and online. Financial consultants provide investment advisory and securities brokerage services to the public.

On December 31, 2006, the Company sold its retail mutual fund management business, WM Advisors, Inc. The results of operations of WM Advisors for the years ended December 31, 2006 and 2005 are reported within the Retail Banking Group's results as discontinued operations and the gain on disposition of these discontinued operations, net of certain transaction expenses, is reported in the Corporate Support/Treasury and Other category.

The **Card Services Group** manages the Company's credit card operations. The segment's principal activities include: (1) issuing credit cards; (2) either holding outstanding balances on credit cards in portfolio or securitizing and selling them; (3) servicing credit card accounts; and (4) providing other cardholder services. Credit card balances that are held in the Company's loan portfolio generate interest income from finance charges on outstanding card balances, and noninterest income from the

collection of fees associated with the credit card portfolio, such as performance fees (late, overlimit and returned check charges) and cash advance and balance transfer fees.

The Card Services Group acquires new customers primarily by leveraging the Company's retail banking distribution network and through direct mail solicitations, augmented by online and telemarketing activities and other marketing programs including affinity programs. In addition to credit cards, this segment markets a variety of other products to its customer base.

The Company evaluates the performance of the Card Services Group on a managed asset basis. Managed financial information is derived by adjusting the GAAP financial information to add back securitized loan balances and the related interest, fee income and provision for credit losses.

The principal activities of the **Commercial Group** include: (1) providing financing to developers and investors, or acquiring loans for the purchase or refinancing of multi-family dwellings and other commercial properties; (2) either holding multi-family and other commercial real estate loans in portfolio or selling these loans while retaining the servicing rights; and (3) providing deposit services to commercial customers.

The principal activities of the **Home Loans Group** include: (1) the origination, fulfillment and servicing of home loans; (2) the origination, fulfillment and servicing of home equity loans and lines of credit; (3) managing the Company's capital markets operations, which includes the buying and selling of all types of real estate secured loans in the secondary market; and (4) holding the Company's held for investment portfolios of home loans, home equity loans and home equity lines of credit made to higher risk borrowers through the subprime mortgage channel.

During the fourth quarter of 2007, the Company announced that, in response to a fundamental shift in the home mortgage market due to credit dislocation and a prolonged period of reduced capital markets liquidity, it significantly changed the strategic focus of its Home Loans business to accelerate its alignment with the Company's retail banking operations. As part of these restructuring activities, the Company discontinued all remaining lending through its subprime mortgage channel, closed approximately 200 home loan locations, including 190 home loan centers and sales offices and nine home loans processing and call centers, eliminated approximately 2,600 positions in the Home Loans business, initiated the closure of WaMu Capital Corp., its institutional broker-dealer business, and began winding-down its mortgage banker finance warehouse lending operation.

The segment offers a wide variety of real estate secured residential loan products and services. Such loans are held in portfolio by the Home Loans Group, sold to secondary market participants or transferred through inter-segment sales to the Retail Banking Group. During the second half of 2007, loans that historically had been transferred to the held for investment portfolio within the Retail Banking Group were retained within the held for investment portfolio within the Home Loans Group. The decision to retain or sell loans, and the related decision to retain or not retain servicing when loans are sold, involves the analysis and comparison of expected interest income and the interest rate and credit risks inherent with holding loans in portfolio, with the expected servicing fees, the size of the gain or loss that would be realized if the loans were sold and the expected expense of managing the risk related to any retained mortgage servicing rights.

The principal activities of, and charges reported in, the **Corporate Support/Treasury and Other** category include:

- management of the Company's interest rate risk, liquidity position and capital. These responsibilities involve managing a majority of the Company's portfolio of investment securities and providing oversight and direction across the enterprise over matters that impact the profile of the Company's balance sheet. Such matters include determining the optimal product composition of loans that the Company holds in portfolio, the appropriate mix of wholesale and

- capital markets borrowings at any given point in time and the allocation of capital resources to the business segments;
- enterprise-wide management of the identification, measurement, monitoring, control and reporting of credit, market and operational risk;
- community lending and investment activities, which help fund the development of affordable housing units in traditionally underserved communities;
- general corporate overhead costs associated with the Company's facilities, legal, accounting and finance functions, human resources and technology services;
- costs that the Company's chief operating decision maker did not consider when evaluating the performance of the Company's four operating segments, including: (1) costs associated with the Company's productivity and efficiency initiatives; (2) costs related to the partial MSR sale in 2006; and (3) gain on the disposition of discontinued operations;
- the impact of changes in the unallocated allowance for loan losses;
- the net impact of funds transfer pricing for loan and deposit balances; and
- items associated with transfers of loans from the Retail Banking Group to the Home Loans Group when home loans previously designated as held for investment are transferred to held for sale, such as lower of cost or fair value adjustments and the write-off of the inter-segment profit factor.

The Company uses various **management accounting methodologies**, which are enhanced from time to time, to assign certain balance sheet and income statement items to the responsible operating segment. Unlike financial accounting, there is no comprehensive, authoritative guidance for management accounting. The management accounting process measures performance based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. Methodologies that are applied to the measurement of segment profitability include:

- a funds transfer pricing system, which allocates interest income funding credits and funding charges between the operating segments and the Treasury Division. A segment will receive a funding credit from the Treasury Division for its liabilities and its share of risk-adjusted economic capital. Conversely, a segment is assigned a charge by the Treasury Division to fund its assets. The system takes into account the interest rate risk profile of the Company's assets and liabilities and concentrates their sensitivities within the Treasury Division, where the risk profile is centrally managed. Certain basis and other residual risks are managed and reported in the operating segments;
- the allocation of charges for services rendered to certain segments by functions centralized within another segment, as well as the allocation of certain operating expenses that are not directly charged to the segments (i.e., corporate overhead), which generally are based on each segment's consumption patterns;
- the allocation of goodwill and other intangible assets to the operating segments based on benefits received from each acquisition;
- the accounting for inter-segment transactions, which include the transfer from the Home Loans Group to the Retail Banking Group of certain originated home and home equity loans that are to be held in portfolio and a revenue arrangement between Home Loans and Retail Banking. When originated home and home equity loans are transferred to the Retail Banking Group, the Home Loans Group records a gain on the sale of the loans based on an assumed inter-segment profit factor. This profit factor is included in the book value of the transferred loans and is

amortized as an adjustment to the net interest income recorded by the Retail Banking Group while the loan is held for investment. With the severe contraction in secondary mortgage market liquidity during the second half of 2007, the Company's chief operating decision maker determined that it was more relevant to measure the performance of the Home Loans Group without considering the assumed profit factor. Accordingly, home loans originated by the Home Loans Group during the second half of 2007 were retained within its portfolio, thereby not subjecting those loans to the inter-segment transfer profit factor. When a loan that was designated as held for investment within the Retail Banking Group is subsequently transferred to held for sale, the remaining inter-segment profit factor is written off through Corporate Support/Treasury and Other. When home loans initiated through retail banking stores are transferred to held for sale, the Retail Banking Group records a gain on sale of those loans based on an assumed inter-segment profit factor. The results of all inter-segment activities are eliminated as reconciling adjustments that are necessary to conform the presentation of management accounting policies to the accounting principles used in the Company's consolidated financial statements; and

a provisioning methodology that is consistent with that used in financial accounting.

Financial highlights by operating segments were as follows:

Retail Banking Group

	Year Ended December 31,			Percentage Change	
	2007	**2006**	**2005**	**2007/2006**	**2006/2005**
	(dollars in millions)				
Condensed income statement:					
Net interest income	$ 5,142	$ 5,201	$ 4,893	(1)%	6%
Provision for loan losses	1,134	167	119	577	41
Noninterest income	3,254	2,914	2,575	12	13
Inter-segment revenue	48	58	42	(18)	39
Noninterest expense	4,567	4,364	4,177	5	4
Income from continuing operations before income taxes	2,743	3,642	3,214	(25)	13
Income taxes	869	1,392	1,216	(38)	14
Income from continuing operations	1,874	2,250	1,998	(17)	13
Income from discontinued operations		38	38		
Net income	$ 1,874	$ 2,288	$ 2,036	(18)	12
Performance and other data:					
Efficiency ratio	54.09%	53.39%	55.63%	1	(4)
Average loans	$ 149,409	$ 177,401	$ 163,405	(16)	9
Average assets	159,184	187,735	173,631	(15)	8
Average deposits	144,233	140,344	136,893	3	3
Loan volume	18,926	20,354	32,953	(7)	(38)
Employees at end of period	28,784	27,629	32,751	4	(16)

The decrease in net interest income in 2007 was primarily due to a decline in the average balances of home mortgage loans. This decline reflects the transfer of approximately $17.5 billion medium-term adjustable-rate portfolio home loans in the fourth quarter of 2006 to held for sale in the Home Loans Group. The decline in average loans was also driven by the decision to retain home loans originated in the second half of 2007 by the Home Loans Group within that segment's portfolio. The decrease in net interest income was partially offset by a $3.89 billion growth in average deposits.

The substantial increase in the provision for loan losses in 2007 was the result of increased delinquencies from the deteriorating housing market and the subsequent impact on losses in the portfolio.

The increase in noninterest income in 2007 was substantially due to a 13% increase in depositor and other retail banking fees, reflecting the strong growth in the number of noninterest-bearing checking accounts and higher transaction fees. The number of noninterest-bearing retail checking accounts at December 31, 2007 totaled approximately 11.0 million, compared with approximately 9.6 million at December 31, 2006. Noninterest income for the year ended December 31, 2006 included a $21 million incentive payment received as part of the Company's migration of its debit card business to MasterCard.

Noninterest expense increased primarily due to higher compensation and benefits expense and occupancy and equipment expense within the retail banking franchise. Compensation and benefits expense increased due to higher performance-based incentive compensation and a 4% increase in headcount related to the opening of 32 net new retail banking stores in 2007. Included in noninterest expense for 2007 was foreclosed asset expense of $60 million.

Card Services Group (Managed basis)

	Year Ended December 31,		October 1, 2005 (Acquisition Date) through December 31, 2005	Percentage Change
	2007	2006		2007/2006
	(dollars in millions)			
Condensed income statement:				
Net interest income	$ 2,659	$ 2,496	$ 642	7%
Provision for loan losses	2,113	1,647	454	28
Noninterest income	1,581	1,528	352	4
Noninterest expense	1,337	1,205	275	11
Income before income taxes	790	1,172	265	(33)
Income taxes	250	448	100	(44)
Net income	$ 540	$ 724	$ 165	(25)
Performance and other data:				
Efficiency ratio	31.53%	29.96%	27.63%	5
Average loans	$ 25,066	$ 21,294	$ 4,908	18
Average assets	27,502	23,888	5,595	15
Employees at end of period	2,860	2,611	3,124	10

The Company evaluates the performance of the Card Services Group on a managed basis. Managed financial information is derived by adjusting the GAAP financial information to add back securitized loan balances and the related interest, fee income and provision for credit losses.

The increase in net interest income in 2007 was substantially due to higher average balances of managed credit card loans, which increased $3.77 billion from 2006. The increase was partially offset by lower yields, reflecting the decrease in the prime interest rate and a shift to retail accounts which have a narrower spread.

The increase in the provision for loan losses reflects the increase in balances of managed credit card loans and the softening of the economy resulting in increases in delinquencies and lower levels of anticipated recoveries.

The increase in noninterest income during 2007 was substantially due to increased gain on securitizations due to a higher volume of securitizations and higher fee income. The increase was substantially offset by market valuation losses resulting from changes in performance assumptions and the disruption in the capital markets.

Noninterest expense increased largely from charges of $88 million for Visa related litigation liabilities.

Commercial Group

	Year Ended December 31,			Percentage Change	
	2007	**2006**	**2005**	**2007/2006**	**2006/2005**
	(dollars in millions)				
Condensed income statement:					
Net interest income	$ 820	$ 719	$ 758	14%	(5)%
Provision for loan losses	24	(82)	(26)		218
Noninterest income	35	99	200	(65)	(50)
Noninterest expense	282	259	243	9	7
Income before income taxes	549	641	741	(14)	(14)
Income taxes	174	245	279	(29)	(12)
Net income	$ 375	$ 396	$ 462	(5)	(14)
Performance and other data:					
Efficiency ratio	32.93%	31.68%	25.32%	4	25
Average loans	$ 38,975	$ 33,230	$ 30,308	17	10
Average assets	41,296	35,565	33,351	16	7
Average deposits	12,722	10,364	7,796	23	33
Loan volume	16,873	12,854	11,231	31	14
Employees at end of period	1,406	1,416	1,325	(1)	7

The increase in net interest income in 2007 was primarily due to increased interest income on higher average balances of multi-family and non-residential real estate loans. Average loan balances reflect the acquisition of Commercial Capital Bancorp on October 1, 2006.

The increase in the provision for loan losses during 2007 was primarily due to growth in loan balances. The provision in 2006 included a $60 million reduction in the allowance related to refinements in the Company's estimate of the allowance attributable to multi-family loans.

A significant portion of the decrease in noninterest income in 2007 was due to losses on trading securities and lower gains on sale of multi-family and commercial loans, net of hedging and risk management instruments.

Noninterest expense in 2007 increased primarily due to the addition of Commercial Capital Bancorp and a 31% increase in loan volume.

Home Loans Group

	Year Ended December 31,			Percentage Change	
	2007	2006	2005	2007/2006	2006/2005
	(dollars in millions)				
Condensed income statement:					
Net interest income	$ 878	$ 1,165	$ 1,966	(25)%	(41)%
Provision for loan losses	985	189	110	421	71
Noninterest income	1,061	1,296	2,425	(18)	(47)
Inter-segment expense	48	58	42	(18)	39
Noninterest expense	3,939	2,295	2,590	72	(11)
Income (loss) before income taxes	(3,033)	(81)	1,649		
Income taxes	(573)	(31)	622		
Net income (loss)	$ (2,460)	$ (50)	$ 1,027		
Performance and other data:					
Efficiency ratio	208.33%	95.48%	59.56%	118	60
Average loans	$ 48,131	$ 47,586	$ 65,077	1	(27)
Average assets	64,695	72,772	87,422	(11)	(17)
Average deposits	7,836	11,535	14,114	(32)	(18)
Loan volume	115,241	171,569	216,308	(33)	(21)
Employees at end of period	11,323	12,934	17,651	(12)	(27)

The decrease in net interest income in 2007 was primarily due to the effect of transfer pricing on lower average balances of custodial deposits resulting from the $2.53 billion sale of mortgage servicing rights in 2006. Also contributing to the decrease was higher transfer pricing charges on subprime loans and higher balances of loans held for investment, which have a lower spread than loans held for sale. Average balances of loans held for investment increased during the second half of 2007, when deteriorating credit conditions caused significant contraction in secondary market liquidity for nonconforming loans, resulting in the Company's decision to transfer approximately $15 billion of such loans from held for sale and retain home loans originated by the Home Loans Group within the segment.

The increase in the provision for loan losses reflects the downturn in the housing market resulting in increased delinquencies and higher credit costs and the impact of the retention of home loans originated by the Home Loans Group within the segment during the second half of 2007.

The decrease in noninterest income in 2007 was primarily due to reduced gain on sale from an illiquid secondary market and decreased sales volume, including a reduced volume of loans sold to the Retail Banking Group, and an increase in trading losses on securities. Partially offsetting this decrease was increased income from MSR valuation and risk management activities and higher loan servicing income.

The increase in noninterest expense in 2007 was predominately due to a $1.78 billion impairment loss recognized in the fourth quarter related to all of this segment's goodwill as a result of the fundamental shift in the mortgage market and the actions the Company is taking to resize its Home Loans business. The increase was partially offset by lower compensation and benefits expense resulting from a reduction in employee headcount. Included in noninterest expense for 2007 was foreclosed asset expense of $245 million.

Corporate Support/Treasury and Other

	Year Ended December 31,			Percentage Change	
	2007	2006	2005	2007/2006	2006/2005
	(dollars in millions)				
Condensed income statement:					
Net interest income (expense)	$ (86)	$ (304)	$ (105)	(72)%	190%
Provision for loan losses	51	(162)	(82)		98
Noninterest income (expense)	(137)	303	(171)		
Noninterest expense	475	684	335	(31)	104
Minority interest expense	203	105		93	
Loss from continuing operations before income taxes	(952)	(628)	(529)	52	19
Income taxes	(308)	(296)	(241)	4	23
Loss from continuing operations	(644)	(332)	(288)	94	15
Income from discontinued operations		406			
Net income (loss)	$ (644)	$ 74	$ (288)		
Performance and other data:					
Average loans	$ 1,403	$ 1,126	$ 931	25	21
Average assets	44,651	40,722	30,143	10	35
Average deposits	35,589	41,586	27,220	(14)	53
Loan volume	462	308	278	50	11
Employees at end of period	5,030	5,234	5,947	(4)	(12)

The improvement in net interest income in 2007 was primarily due to lower interest expense on lower average balances of FHLB borrowings and wholesale deposits.

The decrease in noninterest income was primarily due to $375 million of losses recognized in the second half of 2007 representing impairment on certain mortgage-backed securities where the reduction in fair value was deemed to be other than temporary. Noninterest income for the year ended December 31, 2006 included a litigation award of $149 million from the partial settlement of the Home Savings supervisory goodwill lawsuit.

The decrease in noninterest expense in 2007 is primarily due to lower occupancy and equipment expense as a result of back office location consolidations in 2006 as well as lower compensation and benefits expense resulting from the Company's productivity and efficiency initiatives.

Minority interest expense represents dividends on preferred securities that were issued during 2006 and 2007 by Washington Mutual Preferred Funding LLC ("WMPF LLC"), an indirect subsidiary of Washington Mutual Bank. For further detail, refer to Note 17 to the Consolidated Financial Statements "Preferred Stock and Minority Interest."

On December 31, 2006, the Company completed the sale of WM Advisors, Inc., its retail mutual fund management business. The activities of WM Advisors, Inc. were reported within the Retail Banking Group as discontinued operations. The gain from the sale is included in income from discontinued operations in the Corporate Support/Treasury and Other category.

Off-Balance Sheet Activities and Contractual Obligations

Asset Securitization

The Company transforms loans into securities through a process known as securitization. When the Company securitizes loans, the loans are usually sold to a qualifying special-purpose entity ("QSPE"),

typically a trust. The QSPE, in turn, issues securities, commonly referred to as asset-backed securities, which are secured by future cash flows on the sold loans. The QSPE sells the securities to investors, which entitle the investors to receive specified cash flows during the term of the security. The QSPE uses the proceeds from the sale of these securities to pay the Company for the loans sold to the QSPE. These QSPEs are not consolidated within the financial statements since they satisfy the criteria established by Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* In general, these criteria require the QSPE to be legally isolated from the transferor (the Company), be limited to permitted activities, and have defined limits on the types of assets it can hold and the permitted sales, exchanges or distributions of its assets.

When the Company sells or securitizes loans that it originated, it generally retains the right to service the loans and may retain senior, subordinated, residual, and other interests, all of which are considered retained interests in the sold or securitized assets. Retained interests in mortgage loan securitizations, excluding the rights to service such loans, were $1.71 billion at December 31, 2007, of which $1.56 billion are of investment grade quality. Retained interests in credit card securitizations were $1.84 billion at December 31, 2007, of which $426 million are of investment grade quality. Additional information concerning securitization transactions is included in Notes 7 and 8 to the Consolidated Financial Statements "Securitizations" and "Mortgage Banking Activities."

American Securitization Forum Framework

On December 6, 2007, the American Securitization Forum ("ASF"), working with various constituency groups as well as representatives of U.S. federal government agencies, issued the Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans (the "ASF Framework") to enable residential mortgage loan servicers to streamline their loss avoidance and loan modification practices. In adopting the ASF Framework, the ASF commented that current subprime residential mortgage market conditions reflect a number of concerns that impact securitization transactions, subprime mortgage lending and the overall housing market: an increase in delinquency, default and foreclosure rates; an increase in real estate owned inventories; a decline in home prices; and a prevalence of loans with relatively low initial fixed interest rates that are entering their adjustable rate periods at significantly higher interest rate levels. The ASF Framework provides guidance for residential mortgage loan servicers to streamline subprime residential mortgage borrower evaluation procedures and to facilitate the use of foreclosure avoidance and loss prevention efforts to reduce the number of such borrowers who might default during 2008 because they cannot afford to make higher monthly loan payments after their loans reset to a higher, adjustable interest rate.

The parameters of the ASF Framework were designed by the ASF to improve administrative efficiency while still maximizing cash flows to the QSPEs in which residential mortgage loans were transferred upon securitization by stratifying subprime borrowers into the following segments: borrowers that can refinance into readily available mortgage industry products ("Segment 1"); borrowers that have demonstrated the ability to pay their introductory rates, are unable to refinance, and are unable to afford their reset rates ("Segment 2"); and borrowers that require in-depth, case-by-case analysis due to loan histories that demonstrate difficulties in making timely, introductory rate payments ("Segment 3"). Consistent with its objectives, the ASF Framework was designed to fast-track loan modifications for Segment 2 borrowers, in which default is considered to be reasonably foreseeable. Under the ASF Framework, fast-track loan modifications would be available to Segment 2 borrowers with first-lien residential mortgage loans that: (1) have an initial fixed interest rate period of 36 months or less; (2) are included in securitized pools; (3) were originated between January 1, 2005 and July 31, 2007; and (4) have an initial interest rate reset date between January 1, 2008 and July 31, 2010. To be eligible for a fast-track loan modification under the ASF Framework, Segment 2 borrowers would also have to occupy the property as their primary residence and meet a specific FICO test, which is based on their current

FICO score, and the servicer must ascertain that the upcoming loan rate reset will result in an increase in the loan payment amount by more than 10%. If all of these criteria are satisfied, the servicer would be permitted to modify the Segment 2 borrower's loan interest rate by keeping it at the existing fixed interest rate, generally for five years following the upcoming reset period.

On January 8, 2008, the Securities and Exchange Commission's (the "SEC") Office of the Chief Accountant (the "OCA") issued a letter (the "OCA Letter") addressing accounting issues that may be raised by the ASF Framework. Specifically, the OCA Letter expressed the view that if a subprime loan made to a Segment 2 borrower is modified in accordance with the ASF Framework and that loan could be legally modified, the OCA would not object to continued status of the transferee as a QSPE under Statement No. 140.

As acknowledged in the OCA Letter, a uniform definition of a subprime mortgage loan does not exist within the mortgage banking industry. The Company has defined subprime residential mortgage loans by reference to the channel in which such loans were originated or purchased. Accordingly, the Company considers loans that were either originated under the Company's Long Beach Mortgage name or that were purchased from entities that are recognized as subprime lenders to comprise its population of subprime mortgage loans.

As of December 31, 2007, the Company had not yet applied the loss mitigation approaches as outlined in the ASF Framework. The Company chose to adopt this framework during the first quarter of 2008 and does not expect that its application will impact the off-balance sheet status of the QSPEs that hold these subprime ARM loans.

Contractual Obligations

The following table presents, as of December 31, 2007, the Company's significant fixed and determinable contractual obligations, within the categories described below, by payment date or contractual maturity. These contractual obligations, except for the operating lease obligations and purchase obligations, are included in the Consolidated Statements of Financial Condition. The most significant purchase obligations are contracts related to services. The payment amounts represent those amounts contractually due to the recipient.

	Payments Due by Period (in millions)				
	Total	**Due within One Year**	**After One but within Three Years**	**After Three but within Five Years**	**More than Five Years**
Contractual Obligations					
Debt obligations	$ 106,944	$ 47,431	$ 25,645	$ 18,342	$ 15,526
Capital lease obligations	47	9	18	8	12
Operating lease obligations	2,074	415	664	410	585
Purchase obligations[(1)]	1,047	279	437	256	75
Total contractual obligations	$ 110,112	$ 48,134	$ 26,764	$ 19,016	$ 16,198

NOTE: At December 31, 2007, the liability recorded for uncertain tax positions, excluding associated interest and penalties, was approximately $500 million pursuant to FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). This liability represents an estimate of tax positions that the Company has taken in its tax returns which may ultimately not be sustained upon examination by the tax authorities. Since the ultimate amount and timing of any future cash settlements cannot be predicted with reasonable certainty, the estimated FIN 48 liability has been excluded from the contractual obligations table.

(1) Purchase obligations are defined as an agreement to purchase goods or services that is enforceable and legally binding whereby the Company commits to a fixed or minimum purchase amount over a specified period of time. Estimated payments for contracts that may be terminated early without penalty are shown through the first termination date; all others are shown through the date of contract termination. Excluded from the table are purchase obligations expected to be settled in cash within 90 days of the end of the reporting period.

The Company enters into derivative contracts under which the Company is required to either receive cash or pay cash to counterparties depending on changes in interest or foreign exchange rates. Derivative contracts are carried at fair value in the Consolidated Statements of Financial Condition with the fair value representing the net present value of expected future cash receipts or payments based on market interest rates as of the balance sheet date. The fair value of the contracts changes as a result of fluctuations in market interest rates. Further discussion of derivative instruments is included in Notes 1 and 23 to the Consolidated Financial Statements "Summary of Significant Accounting Policies" and "Derivative Financial Instruments."

Commitments, Guarantees and Contingencies

The Company may incur liabilities under certain contractual agreements contingent upon the occurrence of certain events. A discussion of these contractual arrangements under which the Company may be held liable is included in Note 15 to the Consolidated Financial Statements "Commitments, Guarantees and Contingencies." In addition, the Company has commitments and obligations under pension and other postretirement benefit plans as described in Note 22 to the Consolidated Financial Statements "Employee Benefits Programs and Other Expense."

Risk Management

The Company is exposed to four major categories of risk: credit, liquidity, market and operational.

The Company's Chief Enterprise Risk Officer is responsible for enterprise-wide risk management. The Company's Enterprise Risk Management function oversees the identification, measurement, monitoring, control and reporting of credit, market and operational risk. The Company's Treasury function is responsible for the measurement, management and control of liquidity risk. The Internal Audit function, which reports to the Audit Committee of the Board of Directors, independently assesses the Company's compliance with risk management controls, policies and procedures.

The Board of Directors, assisted by the Audit and Finance Committees on certain delegated matters, oversees the monitoring and controlling of significant risk exposures, including the policies governing risk management. The Corporate Relations Committee of the Board of Directors oversees the Company's reputation and those elements of operational risk that impact the Company's reputation. Governance and oversight of credit, liquidity and market risks are provided by the Finance Committee of the Board of Directors. Governance and oversight of operational risk is provided by the Audit Committee of the Board of Directors.

Management's governing risk committee is the Enterprise Risk Management Committee. This committee and its subcommittees include representation from the Company's lines of business and the Enterprise Risk Management function. Subcommittees of the Enterprise Risk Management Committee provide specialized risk governance and include the Credit Risk Management Committee, the Market Risk Committee and the Operational Risk Committee.

Members of the Enterprise Risk Management function work with the lines of business to establish appropriate policies, standards and limits designed to maintain risk exposures within the Company's risk tolerance. Significant risk management policies approved by the relevant management committees are also reviewed and approved by the Audit and Finance Committees. Enterprise Risk Management also provides objective oversight of risk elements inherent in the Company's business activities and practices, oversees compliance with laws and regulations, and reports periodically to the Board of Directors.

Management is responsible for balancing risk and reward in determining and executing business strategies. Business lines, Enterprise Risk Management and Treasury divide the responsibilities of conducting measurement and monitoring of the Company's risk exposures. Risk exceptions, depending

on their type and significance, are elevated to management or Board committees responsible for oversight.

Credit Risk Management

Credit risk is the risk of loss arising from adverse changes in a borrower's or counterparty's actual or perceived ability to meet its financial obligations under agreed-upon terms and exists primarily in lending, securities and derivative portfolios. The degree of credit risk will vary based on many factors including the size of the asset or transaction, the contractual terms of the related documents, the credit characteristics of the borrower, the channel through which assets are acquired, the features of loan products or derivatives, the existence and strength of guarantor support and the availability, quality and adequacy of any underlying collateral. The degree of credit risk and level of credit losses is highly dependent on the economic environment that unfolds subsequent to originating or acquiring assets. The extent of asset diversification and concentrations also affect total credit risk. Credit risk is assessed through analyzing these and other factors.

The Company's credit risk management process provides for management and accountability to be decentralized through our lines of business. The Chief Credit Officer's primary responsibilities include directing the activities of the Credit Risk Management Committee, overseeing portfolio performance and ensuring compliance with established credit policies, standards and limits, determining the reasonableness of the Company's allowance for loan losses, reviewing and approving large credit exposures, and delegating credit approval authorities. Each business segment has a chief risk officer who is primarily responsible for managing credit, market and operational risk within their business segment. Segment chief risk officers have both transaction approval authority and governance authority for the approval of products, programs and guidelines within established policies, standards and limits. The Chief Credit Officer reports directly to the Chief Enterprise Risk Officer. Segment chief risk officers have dual reporting responsibilities to the Chief Enterprise Risk Officer and to their respective segment President.

The Credit Risk Management Committee is comprised of the Chief Credit Officer, business segment chief risk officers, and senior finance, treasury and portfolio management professionals. This Committee addresses a variety of matters including credit strategy and governance and is primarily responsible for approving new or amended credit standards and recommending new or amendments to significant credit policies to the Enterprise Risk Management Committee for approval by the Finance Committee of the Board of Directors.

U.S. Housing Market Conditions and their Impact on the Company's Loan Portfolio

Following a prolonged period of growth, deteriorating conditions in the U.S. housing market that became evident in the first half of 2007 accelerated throughout the remainder of the year. The decline in home price appreciation rates in the first half of 2007 and absolute declines in home prices in the second half of 2007 has been particularly abrupt in California and Florida, where approximately 48% and 10% of the Company's single-family residential mortgage loans at December 31, 2007 are located. The significant and abrupt decline in secondary market liquidity for home loans which are not eligible for sale to housing government-sponsored enterprises ("nonconforming" loans) contributed to the decrease in the availability of housing credit. As many lenders have been forced out of business or have severely curtailed their operations and most remaining lenders have increased nonconforming mortgage interest rates and tightened underwriting standards, many borrowers, particularly subprime borrowers, borrowers in markets with declining housing prices and borrowers wanting nonconforming loans, have been unable either to refinance existing loans or sell their homes. Similarly, certain prospective home buyers have found it both harder to obtain credit and have found credit more expensive. These forces have combined to result in a supply of unsold homes in December 2007 of approximately 9.7 months, a 47% increase from December 2006, which in turn has contributed to a 7% decline in the national

median sales price for existing homes between those same periods. Housing market weakness was also evident in the change in the national volume of foreclosure filings which increased by 75% in 2007 from 2006.

Faced with these unfavorable conditions, an increasing number of borrowers, including those with adjustable-rate mortgages that repriced upward at the expiration of their fixed rate periods, have defaulted on their loans thereby contributing to an increase in delinquency rates. Furthermore, the rate at which delinquent loans moved through delinquency stages towards foreclosure increased in the fourth quarter of 2007. This increase in late stage delinquencies is evident in the ratio of nonperforming assets to total assets which increased from 0.57% at the end of 2005 to 0.80% at the end of 2006 to 2.17% at December 31, 2007. Loss severities on foreclosed assets have also increased more than expected as lower collateral values on foreclosed properties have been insufficient to cover the recorded investment in the loan. Reflecting higher incurred losses inherent in the portfolio resulting primarily from these economic factors, the Company increased its allowance for loan losses, both in absolute terms and as a percentage of loans held in portfolio from $1.70 billion or 0.74% of loans held in portfolio at the end of 2005 to $2.57 billion or 1.05% of total loans held in portfolio at December 31, 2007.

Key Factors Affecting Credit Costs: Lien Position, Loan-to-Value Ratios and Loan Vintages

In a stressed housing market with increasing delinquencies and declining housing prices, such as currently exists, the adequacy of collateral securing a loan becomes an important factor in determining future loan performance as borrowers with more equity in their properties generally have a greater vested interest in keeping their loans current than borrowers with little to no equity in their properties. Generally speaking, homes purchased prior to the end of 2004 have benefited from more home price appreciation than homes purchased more recently. Unless a borrower has withdrawn substantial amounts of equity from the collateralized property, the credit performance of earlier vintage loans in the Company's residential loan portfolio is generally more favorable than loans originated or purchased more recently.

In the event that the Company forecloses on a property, the extent to which the outstanding balance on a loan exceeds its collateral value (less cost to sell) will determine the severity of loss. Generally speaking, properties with higher current loan-to-value ratios would be expected to result in higher severity of loss on foreclosure than properties with lower current loan-to-value ratios. Both loan-to-value ratios at origination and estimated current loan-to-value ratios are key inputs in estimating the allowance for loan losses.

Statistical estimation techniques used to estimate the allowance for loan losses in single family residential portfolios incorporate estimates of changes in housing prices using Office of Federal Housing Enterprise Oversight ("OFHEO") cumulative growth rates available at the time the assessments are conducted. The estimate of the allowance at December 31, 2007 incorporated OFHEO data as of September 30, 2007 as well as more current data evidencing conditions in the housing market, such as provided by the National Associations of Realtors, and internal estimates of future loss severity. On February 26, 2008, OFHEO published its estimate of changes in the housing price index as of December 31, 2007. Estimates of changes in the housing price index made by the Company in the fourth quarter of 2007 were determined to be in-line with those published by OFHEO. As indicated in the footnotes to the loan-to-value/vintage tables that follow, estimated current loan-to-value ratios reflected in the tables are estimated using OFHEO home price index data as of September 30, 2007.

In foreclosure proceedings, lien position is also a critical determinant of severity of loss because when the Company holds a lien on a property that is subordinate to a first lien mortgage held by another lender, both the probability of loss and severity of loss risk are generally higher than when the Company holds both the first lien home loan and second lien home equity loan or line of credit. In the event of foreclosure, the probability of loss is generally higher because the first lien holder does not have to take into consideration any losses the second lien holder may sustain when deciding whether to foreclose on a property. The severity of loss risk is higher principally because a second lien holder who exercises its right to foreclose on a property must ensure the first lien holder's investment is repaid in full.

The table below analyzes the composition of the unpaid principal balance ("UPB") of home loans held in portfolio at December 31, 2007:

	Year of Origination					
Loan-to-Value Ratio at Origination	**Pre-2005**	**2005**	**2006**	**2007**	**Total UPB**	**% of Total**
	(UPB in millions)					
Home loans:						
≤50%	$ 3,827	$ 1,278	$ 845	$ 2,960	$ 8,910	8%
>50-60%	4,168	1,826	1,461	4,039	11,494	11
>60-70%	9,445	5,271	3,866	7,867	26,449	24
>70-80%	16,319	11,240	10,277	17,840	55,676	51
>80-90%	1,843	687	608	1,596	4,734	4
>90%	837	184	202	418	1,641	2
Home loans held in portfolio[(1)(2)(3)(4)]	$ 36,439	$ 20,486	$ 17,259	$ 34,720	$ 108,904	100%
As a percentage of total UPB	33%	19%	16%	32%	100%	
Average loan-to-value ratio at origination	69	71	72	70	70	
Average estimated current loan-to-value ratio[(5)]	46	66	75	71	62	

(1) Excludes home loans in the subprime mortgage channel.

(2) Excluded from the balances of home loans held in portfolio are $553 million of home loans that are insured by the Federal Housing Administration ("FHA") or guaranteed by the Department of Veterans Affairs ("VA"), of which $38 million have loan-to-value ratios of ≤80% and $515 million have loan-to-value ratios of >80%.

(3) Included in the balance of home loans held in portfolio are the following interest-only home loans and their related loan-to-value ratios at origination: $28.64 billion (≤80%), $997 million (>80-90%) and $253 million (>90%). The volume of interest-only loans amounted to $18.11 billion in 2007.

(4) The volume of home loans with loan-to-value ratios at origination of >80% amounted to $8.40 billion in 2007.

(5) The average estimated current loan-to-value ratio reflects the UPB outstanding at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the September 30, 2007 Office of Federal Housing Enterprise Oversight ("OFHEO") home price index.

The table below analyzes the composition of the unpaid principal balance ("UPB") of prime home equity loans and lines of credit held in portfolio at December 31, 2007:

	Year of Origination					
Combined Loan-to-Value Ratio at Origination[1]	Pre-2005	2005	2006	2007	Total UPB	% of Total
	(UPB in millions)					
Prime home equity loans and lines of credit:						
≤50%	$ 2,896	$ 1,340	$ 1,515	$ 1,504	$ 7,255	12%
>50-60%	1,831	931	991	1,038	4,791	8
>60-70%	2,678	1,522	1,550	1,706	7,456	13
>70-80%	6,029	4,233	3,997	4,857	19,116	32
>80-90%	2,730	4,057	5,693	6,624	19,104	32
>90%	618	232	271	567	1,688	3
Prime home equity loans and lines of credit held in portfolio[2][3][4][5]	$ 16,782	$ 12,315	$ 14,017	$ 16,296	$ 59,410	100%
As a percentage of total UPB	28%	21%	24%	27%	100%	
Average combined loan-to-value ratio at origination[1]	68	74	75	76	73	
Average estimated current combined loan-to-value ratio[1][6]	49	65	73	76	65	

(1) The combined loan-to-value ratio at origination measures the ratio of the original loan amount of the first lien product (typically a first lien mortgage loan) and the original loan amount of the second lien product (typically a second lien home equity loan or line of credit) to the appraised value of the underlying collateral at origination. Where the second lien product is a line of credit, the total commitment amount is used in calculating the combined loan-to-value ratio.

(2) Excludes home equity loans in the subprime mortgage channel.

(3) 27% of prime home equity loans and lines of credit were in first lien position at December 31, 2007.

(4) The Company has pool mortgage insurance that generally insulates it from the risk of default on certain prime home equity loans and lines of credit originated after March 2004 where the combined loan-to-value ratio at origination is greater than 90 percent. Contractual stop loss provisions limit the insurer's exposure to 10% of the outstanding loan balance for loans originated prior to December 31, 2006, and 8% for loans originated thereafter.

(5) The volume of prime home equity loans and lines of credit with combined loan-to-value ratios at origination of >80% amounted to $10.10 billion in 2007.

(6) The average estimated current combined loan-to-value ratio reflects the UPB outstanding or commitment amount (in the case of lines of credit) at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the September 30, 2007 OFHEO home price index.

The unpaid principal balance ("UPB") of prime home equity loans and lines of credit held in portfolio at December 31, 2007, as shown in the immediately preceding table, included the following home equity loans and lines of credit in *junior lien* position:

	Year of Origination					
Combined Loan-to-Value Ratio at Origination[1]	**Pre-2005**	**2005**	**2006**	**2007**	**Total UPB**	**% of Total**
	(UPB in millions)					
Prime *junior lien* home equity loans and lines of credit:						
≤50%	$ 1,015	$ 654	$ 922	$ 729	$ 3,320	8%
>50-60%	905	642	832	685	3,064	7
>60-70%	1,533	1,158	1,365	1,148	5,204	12
>70-80%	3,798	3,381	3,573	3,349	14,101	32
>80-90%	2,303	3,694	5,461	5,181	16,639	38
>90%	338	100	212	496	1,146	3
Total prime *junior lien* home equity loans and lines of credit held in portfolio[2][3]	$ 9,892	$ 9,629	$ 12,365	$ 11,588	$ 43,474	100%
As a percentage of total UPB	23%	22%	28%	27%	100%	
Average combined loan-to-value ratio at origination[1]	73	76	77	78	76	
Average estimated current combined loan-to-value ratio[1][4]	54	68	75	78	69	

(1) The combined loan-to-value ratio measures the ratio of the original loan amount of the first lien product (typically a first lien mortgage loan) and the original loan amount of the second lien product (typically a second lien home equity loan or line of credit) to the appraised value of the underlying collateral. Where the second lien product is a line of credit, the total commitment amount is used in calculating the combined loan-to-value ratio.

(2) Excludes home equity loans in the subprime mortgage channel.

(3) The Company has pool mortgage insurance that generally insulates it from the risk of default on certain prime home equity loans and lines of credit originated after March 2004 where the combined loan-to-value ratio at origination is greater than 90 percent. Contractual stop loss provisions limit the insurer's exposure to 10% of the outstanding loan balance for loans originated prior to December 31, 2006, and 8% for loans originated thereafter.

(4) The average estimated current combined loan-to-value ratio reflects the UPB outstanding or commitment amount (in the case of lines of credit) at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the September 30, 2007 OFHEO home price index.

Option ARM Home Loans

The Option ARM home loan product is an adjustable-rate mortgage loan that provides the borrower with the option each month to make a fully-amortizing, interest-only, or minimum payment. As described in greater detail below, the minimum payment is typically insufficient to cover interest accrued in the prior month and any unpaid interest is deferred and added to the principal balance of the loan. In the current housing market, the popularity of Option ARM loans has decreased and loan volumes have declined from $65.16 billion in 2005 to $42.59 billion in 2006 to $25.78 billion in 2007.

Loan Features

The minimum payment on an Option ARM loan is based on the interest rate charged during the introductory period. This introductory rate has usually been significantly below the fully-indexed rate. The fully-indexed rate is calculated using an index rate plus a margin. Once the introductory period ends, the contractual interest rate charged on the loan increases to the fully-indexed rate and adjusts monthly to reflect

movements in the index.

If the borrower continues to make the minimum monthly payment after the introductory period ends, the payment may not be sufficient to cover interest accrued in the previous month. In this case, the loan will "negatively amortize" as unpaid interest is deferred and added to the principal balance of the loan. The minimum payment on an Option ARM loan is adjusted on each anniversary date of the loan but each increase or decrease is limited to a maximum of 7.5% of the minimum payment amount on such date until a "recasting event" occurs.

A recasting event occurs every 60 months or sooner upon reaching a negative amortization cap. When a recasting event occurs, a new minimum monthly payment is calculated without regard to any limits on the increase or decrease in amount that would otherwise apply under the annual 7.5% payment cap. This new minimum monthly payment is calculated to be sufficient to fully repay the principal balance of the loan, including any theretofore deferred interest, over the remainder of the loan term using the fully-indexed rate then in effect. A recasting event occurs immediately whenever the unpaid principal balance reaches the negative amortization cap, which is expressed as a percent of the original loan balance. Prior to 2006, the negative amortization cap was 125% of the original loan balance (or 110% of the original loan balance for loans secured by property located in New York and loans purchased through the correspondent channel). For all Option ARM loans originated in 2006, the negative amortization cap was 110% of the original loan balance. For Option ARM loans originated in 2007, the negative amortization cap was raised to 115%, with the exception of loans secured by property located in New York and loans purchased through the correspondent channel where the negative amortization cap remains at 110%. Declines in mortgage rates to which Option ARM loans are indexed will generally delay the timeframe within which negatively amortizing Option ARM loans reach their negative amortization caps. Conversely, increases in mortgage rates to which Option ARM loans are indexed will generally accelerate the timeframe within which negatively amortizing Option ARM loans reach their negative amortization caps.

In the first month that follows a recasting event, the minimum payment will equal the fully-amortizing payment. If in subsequent months the index rate decreases, the minimum payment may exceed the fully-amortizing payment. Conversely, if the index rate increases in subsequent months, negative amortization may resume. In this situation, the 7.5% annual payment cap will once again operate to limit the change in the minimum payment until another recasting event occurs.

Assuming all Option ARM loans recast no earlier than five years after origination, as of December 31, 2007, 8% of the Company's Option ARM portfolio is scheduled to recast in 2008 and 13% is scheduled to recast in 2009.

Loan Performance

The table below analyzes the composition of the unpaid principal balance ("UPB") of Option ARM home loans held in portfolio at December 31, 2007:

	Year of Origination					
Loan-to-Value Ratio at Origination	**Pre-2005**	**2005**	**2006**	**2007**	**Total UPB**	**% of Total**
	(UPB in millions)					
Home loan Option ARMs						
≤50%	$ 1,202	$ 719	$ 458	$ 753	$ 3,132	5%
>50-60%	1,439	1,076	883	1,344	4,742	8
>60-70%	4,327	3,525	2,835	3,333	14,020	24
>70-80%	8,521	7,429	8,421	8,519	32,890	57
>80-90%	1,017	495	504	939	2,955	5
>90%	288	92	152	125	657	1
Total home loan Option ARMs held in portfolio	$ 16,794	$ 13,336	$ 13,253	$ 15,013	$ 58,396	100%
As a percentage of total UPB	29%	23%	23%	25%	100%	
Average loan-to-value ratio at origination	71	71	73	73	72	
Average estimated current loan-to-value ratio[1]	48	69	77	74	66	

(1) The average estimated current loan-to-value ratio reflects the UPB outstanding at the balance sheet date, divided by the estimated current property value. Current property values are estimated using data from the September 30, 2007 OFHEO home price index.

Key statistics for Option ARM loans held in the Company's home loan portfolio are set forth in the following table:

	December 31,		
	2007	**2006**	**2005**
	(dollars in millions)		
Loan balance	$ 58,870	$ 63,557	$ 71,201
Capitalized interest recognized in earnings that resulted from negative amortization	1,418	1,068	292
Total amount by which the unpaid principal balance exceeded the original principal amount	1,731	888	160
Balance of loans that experienced a net increase in negative amortization during the year	48,162	48,832	44,796
Percentage of borrowers whose final loan payment of the year resulted in negative amortization:			
By number of loans	50%	51%	42%
By value of loans	69	68	56

The table below provides geographic distribution of the Company's home loan Option ARM portfolio at December 31, 2007:

	Portfolio		Weighted Average Estimated Current Loan-to-Value Ratio
	(dollars in millions)		
California	$ 28,956	49%	66%
Florida	7,605	13	66
New York/New Jersey	5,333	9	62
Washington/Oregon	2,186	3	62
Illinois	1,506	3	67
Texas	528	1	65
Other	12,756	22	69
Total home loan Option ARMs held in portfolio	$ 58,870	100%	66%

Subprime Mortgage Channel

In the fourth quarter of 2007, the Company discontinued all lending in its subprime mortgage channel. This channel is comprised of loans originated under the Company's Long Beach Mortgage name or were purchased from lenders who were generally recognized as lending to subprime borrowers ("Subprime Lenders"). The Company did not originate or purchase loan products with negative amortization features through its subprime mortgage channel. The Company separately reports the performance of loans in its subprime mortgage channel as such loans generally experience higher delinquencies and net charge-offs than prime mortgage loans that possess comparable loan-to-value ratios and credit scores. To compensate for the increased credit risk of such loans, the Company generally charged such borrowers a higher rate of interest than borrowers in the prime channel. As of December 31, 2007, subprime mortgage channel loans held for investment totaled $18.62 billion, including $2.53 billion of home equity loans.

Subprime mortgage channel loans are managed by a dedicated collections department with collectors experienced in subprime mortgage loan collections. Servicing activities for these loans emphasize direct c