WASHINGTON MUTUAL INC
Form 10-K/A
August 09, 2006

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, 2005

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)
1201 Third 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

Securities registered pursuant to Section 12(g) 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 x 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 x.

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 x 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. o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer x Accelerated filer o Non-accelerated filer 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 x.

The aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2005, based on the closing sale price as reported on the New York Stock Exchange:

Common Stock $35,345,279,226(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 February 28, 2006:

Common Stock 992,254,791(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 18, 2006, are incorporated by reference into Part III.

WASHINGTON MUTUAL, INC.
2005 ANNUAL REPORT ON FORM 10-K/A
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(1) Not applicable.

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, 2005 as the result of a recently completed reconciliation project of the Company s current and deferred income tax accounts that resulted in a $337 million reduction to retained earnings, representing cumulative adjustments to net income in prior periods up to and including 2001. No adjustments were made to net income or earnings per share for any of the periods from 2002 through June 30, 2006. Accordingly, these adjustments affected the balance of retained earnings and certain tax accounts at December 31, 2001 and each period thereafter.

This Amendment No. 1 on Form 10-K/A amends:

- Item 7 (Management s Discussion and Analysis of Financial Condition and Results of Operations) to reflect the changes to the Five-Year Summary of Selected Financial Data (page 24), Ratios and Other Supplemental Data (page 25), Earnings Performance from Continuing Operations (page 26) and Capital Adequacy (page 48).

- Item 8 (Financial Statements and Supplementary Data) to reflect changes to the Company s financial statements and notes thereto, including, but not limited to, the Consolidated Statements of Financial Condition, the Consolidated Statements of Stockholders Equity and Comprehensive Income and Note 2 to the Consolidated Financial Statements Restatement of Financial Statements, and the inclusion of the reissued report of the Company s independent auditors.

Except for Items 7 and 8 of Part II, no other information in the Form 10-K is being amended by this Amendment. This Amendment continues to speak as of the date of the original filing of the Form 10-K and the Company has not updated the disclosure in this Amendment to speak as of any later date.

PART I

BUSINESS

Overview

With a history dating back to 1889, Washington Mutual, Inc. (together with its subsidiaries, Washington Mutual, or the Company) is a retailer of financial services to consumers and small businesses. Based on its consolidated assets at December 31, 2005 the Company was the seventh largest among all U.S.-based bank and thrift holding companies.

The Company s earnings are primarily driven by lending to consumers and deposit taking activities which generate net interest income and by activities that generate noninterest income, including the sale and servicing of loans and providing fee-based services to its customers.

Washington Mutual strives to be the nation s leading retailer of financial services for consumers and small businesses. It plans to achieve this by building strong, profitable relationships with a broad spectrum of consumers and businesses. Expanding the Company s retail banking franchise, diversifying its sources of income and achieving efficiencies in operations will be critical to future success.

Following the acquisition of the three largest California-based thrift institutions in the latter part of the 1990s, the Company continued to expand nationally by acquiring companies with strong retail banking franchises in Texas and the greater New York metropolitan area and by building out its branch network into select new markets. During this period, Washington Mutual developed and launched its award-winning and innovative retail banking stores that serve customers in an open, free-flowing retail environment. With the goal of combining its strengths as a deposit taker and portfolio lender with those of a mortgage banker, the Company also expanded its presence in the home loan origination and servicing businesses through acquisition. These mortgage banking acquisitions also served to further broaden the Company s national presence.

Having created a viable branch presence in many of the largest metropolitan areas over the past decade, the Company shifted its retail banking strategy to focus on consumers in markets where the Company has both a home loan and retail banking presence. As compared to its branching strategy over the last decade, this current focus on building stores in its existing markets carries lower execution risk because it enables the Company to leverage both existing infrastructure and brand awareness. For more detail on the products and services offered by the Retail Banking and Financial Services Group, refer to Management s Discussion and Analysis Operating Segments.

The Company s acquisition of Providian Financial Corporation (Providian) on October 1, 2005, has enabled the Company to offer credit cards to both new and existing customers, thereby creating and strengthening those relationships. For more detail on the products and services offered by the Card Services Group, refer to Management s Discussion and Analysis Operating Segments.

In the home loans business, the Company will continue to focus its attention on improving efficiency and productivity by consolidating technology platforms, enhancing customer service and leveraging the Company s distribution network to cross sell additional products and services. For more detail on the products and services offered by the Home Loans Group, refer to Management s Discussion and Analysis Operating Segments.

Multi-family lending complements the Company s expertise in residential real estate secured lending. During 2005, the Company successfully grew this business in its top 15 targeted metropolitan markets. These markets have stable demand, a large disparity between the cost of renting and the cost of home ownership, and households that typically rent for an extended period of time. Its target markets also have supply constraints such as geographic barriers, rent control and zoning restrictions. For more detail on the the

products and services offered by the Commercial Group, of which multi-family lending is the most significant part, refer to Management s Discussion and Analysis Operating Segments.

Available Information

Washington Mutual makes its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to such reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act, available free of charge on or through its website located at www.wamu.com/ir as soon as reasonably practicable after their filing with the United States Securities and Exchange Commission.

The Company has implemented a Code of Ethics applicable to senior financial officers of the Company and a revised Company Code of Conduct applicable to all Company officers, employees and directors. The Code of Ethics provides fundamental ethical principles to which Company senior financial officers are expected to adhere. The Code of Conduct operates as a tool to help Washington Mutual officers, employees and directors understand and adhere to the high ethical standards required for employment by, or association with, the Company. Both the Code of Ethics and the Code of Conduct are available on the Company s website at www.wamu.com/ir. Shareholders may also obtain written copies at no cost by writing the Company at 1201 Third Avenue, Seattle, Washington 98101, Attention: Investor Relations Department, WMT 2140, or by calling (206) 461-3187.

Employees

At December 31, 2005, Washington Mutual had 60,798 employees, compared with 52,579 at December 31, 2004 and 63,720 at December 31, 2003, which in 2003 included 2,346 employees related to the Company s operations that have subsequently been discontinued. During 2005, the number of employees increased primarily due to the acquisition of Providian Financial Corporation, and the continuing expansion of the Company s retail banking franchise. During 2004, the number of employees decreased primarily due to the Company s cost containment initiative directed at reducing the fixed cost structure of the home loans business. The Company believes that it has been successful in attracting quality employees and that employee relations are good.

Factors That May Affect Future Results

The Company s Form 10-K and other documents that it files with the Securities and Exchange Commission contain forward-looking statements. In addition, the Company s senior management may make forward-looking statements orally to analysts, investors, the media and others. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as expects, anticipates, intends, plans, believes, seeks, estimates, or words of similar meaning, or future or conditional verbs such would, should, could or may.

Forward-looking statements provide management s current expectations or predictions of future conditions, events or results. They may include projections of the Company s revenues, income, earnings per share, capital expenditures, dividends, capital structure or other financial items, descriptions of management s plans or objectives for future operations, products or services, or descriptions of assumptions underlying or relating to the foregoing. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. These statements speak only as of the date they are made. Management does not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made. There are a number of factors, many of which are beyond management s control or its ability to accurately forecast or predict their significance, which could cause actual conditions, events or results to differ materially from those described in the forward-looking statements.

Significant among these factors are the following:

Volatile interest rates impact the mortgage banking business.

Changes in interest rates affect the mortgage banking business in complex and significant ways. Changes in interest rates can affect loan origination volumes, gain from mortgage loans and loan servicing fees, which are the principal components of revenue from sales and servicing of home mortgage loans. When mortgage rates decline, the Company generally expects loan volumes to increase as borrowers refinance, which leads to accelerated early payoffs of mortgage loans in its servicing portfolio. As a result, when mortgage rates decline, the fair value of the Company s mortgage servicing rights (MSR) declines and gain from mortgage loans tend to increase. When mortgage rates rise, the Company generally expects loan volumes to decrease, which generally leads to reduced payoffs in its servicing portfolio. As a result, when mortgage rates rise, the fair value of the Company s MSR increases and gain from mortgage loans decrease.

As part of its overall risk management activities, the Company seeks to mitigate changes in fair value of its MSR asset by purchasing and selling financial instruments, entering into interest rate contracts and forward commitments to purchase or sell mortgage-backed securities, and adjusting the mix and amount of such financial instruments or contracts to take into account the effects of different interest rate environments. The MSR asset and the mix of financial instruments used to mitigate changes in its fair value are not perfectly correlated. This imperfect correlation creates the potential for excess MSR risk management gains or losses during any period. The Company s management must exercise judgment in selecting the amount, type and mix of financial instruments and contracts to mitigate changes in fair value of its MSR. The Company cannot assure that the amount, type and mix of financial instruments and contracts it selects will fully offset significant changes in the value of the MSR and the Company s actions could negatively impact earnings. The Company s reliance on these risk management instruments may be impacted by periods of illiquidity in the secondary markets, which could negatively impact the performance of the MSR risk management instruments. For further discussion of how interest rate risk, basis risk and prepayment risk are managed, refer to Management s Discussion and Analysis Market Risk Management.

Rising interest rates, unemployment and decreases in housing prices impact credit performance.

The Company s assessment of its credit profile is based in part on management s evaluation of economic trends that affect the real estate lending environment, which has been generally positive in recent years. With recent increases in short-term interest rates, however, the favorable economic environment may not persist. The Company continually monitors changes in the economy, particularly unemployment rates and housing prices. If unemployment were to rise and either a slowdown in housing price appreciation or outright declines in housing prices were to occur, borrowers might have difficulty repaying their loans. As a result, the Company could experience higher credit losses in its mortgage and home equity portfolios, which could adversely affect its earnings.

Risks related to the option adjustable-rate mortgage product.

The Company continually monitors the credit risk inherent in its option adjustable-rate mortgage product (Option ARM) portfolio and assesses the adequacy of its loan loss allowance in light of prevailing circumstances and the historical and current levels of negative amortization in its Option ARM portfolio. If credit risks associated with the Option ARM were to increase in severity, the Company s earnings could be adversely affected. For further discussion of the Option ARM product, refer to Management s Discussion and Analysis Credit Risk Management.

Risks related to subprime lending.

The Company remains committed to the subprime mortgage market and intends to increase the loan volume of its subprime mortgage business, Long Beach Mortgage Company, and to maintain the size of its purchased subprime home loan portfolio. A portion of the Company s Card Services portfolio is made up of subprime credit card loans and Card Services may continue to originate a portion of its credit card loans to subprime borrowers. If unemployment were to rise or either a slowdown in housing price appreciation or outright declines in housing prices were to occur, subprime borrowers, who tend to have greater vulnerability to such changes than prime borrowers, may be unable to repay their loans and the credit performance of the Company s subprime portfolios could suffer, with a potential adverse effect on earnings.

Risks related to the integration of the Card Services business.

The Company commenced its credit card operations as the result of the merger of Providian Financial Corporation into the Company in a transaction completed on October 1, 2005. The success of the merger will depend, in part, on the Company s ability to realize the anticipated benefits from the merger, such as accelerated growth, enhanced customer relationships and product and earnings diversification. One of the key factors in realizing the anticipated benefits of the merger will be the Company s ability to retain the management personnel from Providian who are leading the Card Services business. As the integration process for the Card Services business continues, it is possible that critical financial, growth or other objectives could be missed, key employees could be lost, or data, communications and other systems or operations could fail to be successfully combined. Integration efforts also divert management attention and resources away from other activities. Any failure to successfully integrate the Card Services business into the Company, loss of key management personnel or any significant delay or unanticipated diversion of resources in completing such integration, could adversely affect the Company s performance.

Risks related to credit card operations.

Credit card lending brings with it certain risks and uncertainties. These include the composition and risk profile of the Company s credit card portfolio and customers, and the Company s ability to continue growing the Company s credit card business. The success of the credit card business will also depend, in part, on the success of its product development, product rollout efforts and marketing initiatives, including the rollout of credit card products to the Company s existing retail and mortgage loan customers, and its ability to continue to successfully target creditworthy customers. Recent disputes involving the Visa and MasterCard networks, including their membership standards and pricing structures, could also result in changes that would be adverse to the credit card business. Changes in interest rates also affect the credit card business, including the costs associated with funding the credit card portfolio and the valuation of retained interests related to credit card securitizations.

Changes in the regulation of financial services companies, housing government-sponsored enterprises and credit card lenders.

Proposals for further regulation of the financial services industry are continually being introduced in Congress. The agencies regulating the financial services industry also periodically adopt changes to their regulations. Proposals that are now receiving a great deal of attention include consumer protection initiatives relating to bank overdraft practices, security of customer information, marketing practices, the Real Estate Settlement Procedures Act, nontraditional loan products including Option ARMs, credit card lending practices and predatory lending. In addition, there continues to be a focus on reform of the housing government-sponsored enterprises (GSEs) including the federal home loan bank system. It is possible that one or more legislative proposals may be adopted or regulatory changes may be made that would have an adverse effect on the Company s business. For further discussion of the regulation of financial services, see Regulation and Supervision.

The Company faces competition from banking and nonbanking companies.

The Company operates in a highly competitive environment and expects competition to continue as financial services companies combine to produce larger companies that are able to offer a wide array of financial products and services at competitive prices. In addition, customer convenience and service capabilities, such as product lines offered and the accessibility of services are significant competitive factors.

The Company s most direct competition for loans comes from commercial banks, other savings institutions, investment banking firms, national mortgage companies and other credit card lenders. Its most direct competition for deposits comes from commercial banks, other savings institutions and credit unions doing business in the Company s market areas. As with all banking organizations, the Company also experiences competition from nonbanking sources, including mutual funds, corporate and government debt securities and other investment alternatives offered within and outside of its primary market areas. In addition, technological advances and the growth of e-commerce have made it possible for non-depository institutions to offer products and services that were traditionally offered only by banks. Many of these competitors have fewer regulatory constraints and some have lower cost structures.

The Company also faces competition for talent. Its success depends, in large part, on its ability to hire and keep key people. Competition for the best people in most businesses in which the Company engages can be intense. If the Company is unable to attract and retain talented people, its business could suffer.

General business and economic conditions, including movements in interest rates, the slope of the yield curve and the potential overextension of housing prices in certain geographic markets.

The Company s business and earnings are sensitive to general business and economic conditions. These conditions include the slope of the yield curve, inflation, the money supply, the value of the U.S. dollar as compared to foreign currencies, fluctuations in both debt and equity capital markets, and the strength of the U.S. economy and the local economies in which the Company conducts business. Changes in these conditions may adversely affect its business and earnings. For example, when short-term interest rates rise, there is a lag period until adjustable-rate mortgages reprice. As a result, the Company may experience compression of its net interest margin with a commensurate adverse effect on earnings. Likewise, the Company s earnings could also be adversely affected when a flat or inverted yield curve develops, as this may inhibit the Company s ability to grow its adjustable-rate mortgage portfolio and may also cause margin compression. A prolonged economic downturn could increase the number of customers who become delinquent or default on their loans, or a rising interest rate environment could increase the negative amortization of Option ARM loans, which may eventually result in increased delinquencies and defaults. Rising interest rates could also decrease customer demand for loans. An increase in delinquencies or defaults could result in a higher level of charge-offs and provision for loan and lease losses, which could adversely affect earnings.

The Company s business and earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies. The Company is particularly affected by the policies of the Board of Governors of the Federal Reserve System, which regulates the supply of money and credit in the United States. Federal Reserve System policies directly and indirectly influence the yield on the Company s interest-earning assets and the cost of its interest-bearing liabilities. Changes in those policies are beyond the Company s control and difficult to predict.

Negative public opinion impacts the Company s reputation.

Reputational risk, meaning the risk to earnings and capital from negative public opinion, is inherent in the Company s business. Negative public opinion can result from the actual or perceived manner in which the Company conducts its business activities, which include its sales and trading practices, its loan origination and servicing activities, its retail banking and credit card operations, its management of actual

or potential conflicts of interest and ethical issues, and its protection of confidential customer information. Negative public opinion can adversely affect the Company s ability to keep and attract customers and can expose it to litigation and regulatory action. The Company takes steps to minimize reputation risk in the way it conducts its business activities and deals with its customers and communities.

Each of the factors discussed in the preceding paragraphs can significantly impact the Company s businesses, operations, activities, condition and results in significant ways that are not described in the foregoing discussion and which are beyond the Company s ability to anticipate or control, and could cause actual results to differ materially from the outcomes described in the forward-looking statements.

Environmental Regulation

The Company s business and properties are subject to federal and state laws and regulations governing environmental matters, including the regulation of hazardous substances and wastes. For example, under the federal Comprehensive Environmental Response, Compensation, and Liability Act and similar state laws, owners and operators of contaminated properties may be liable for the costs of cleaning up hazardous substances without regard to whether such persons actually caused the contamination. Such laws may affect the Company both as an owner or former owner of properties used in or held for its business, and as a secured lender on property that is found to contain hazardous substances or wastes. The Company s general policy is to obtain an environmental assessment prior to foreclosing on commercial property. The Company may elect not to foreclose on properties that contain such hazardous substances or wastes, thereby limiting, and in some instances precluding, the liquidation of such properties.

Regulation and Supervision

The following discussion describes elements of the extensive regulatory framework applicable to savings and loan holding companies as well as federal savings associations and provides some specific information relevant to Washington Mutual. This regulatory framework is primarily intended for the protection of depositors, federal deposit insurance funds and the banking system as a whole rather than for the protection of shareholders and creditors.

To the extent that this section describes statutory and regulatory provisions, it is qualified in its entirety by reference to those provisions. Those statutes and regulations, as well as related policies, are subject to change by Congress, state legislatures and federal and state regulators. Changes in statutes, regulations or regulatory policies applicable to the Company, including interpretation or implementation thereof, could have a material effect on the Company s business.

General

Washington Mutual, Inc. is a Washington State corporation. It owns two federal savings associations as well as numerous nonbank subsidiaries. Washington Mutual, Inc. is a savings and loan holding company. As a savings and loan holding company, Washington Mutual, Inc. is subject to regulation by the Office of Thrift Supervision (the OTS).

The federal savings associations are subject to extensive regulation and examination by the OTS, their primary federal regulator, as well as the Federal Deposit Insurance Corporation (FDIC). On January 1, 2005, the Company s state savings bank, the former Washington Mutual Bank merged into Washington Mutual Bank, FA, and ceased to exist; subsequently, Washington Mutual Bank, FA changed its name to Washington Mutual Bank (WMB). Consequently, the Company no longer owns a state savings bank that is subject to regulation and supervision by the Director of Financial Institutions of the State of Washington. Its nonbank financial subsidiaries are also subject to various federal and state laws and regulations.

Both of the Company s banking subsidiaries are under the common control of Washington Mutual, Inc. and are insured by the FDIC. If an insured institution fails, claims for administrative expenses

of the receiver and for deposits in U.S. branches (including claims of the FDIC as subrogee of the failed institution) have priority over the claims of general unsecured creditors. In addition, the FDIC has authority to require either of the Company s banking subsidiaries to reimburse it for losses it incurs in connection with the failure of the other banking subsidiary or with the FDIC s provision of assistance to a Washington Mutual banking subsidiary that is in danger of failure.

Payment of Dividends

Washington Mutual, Inc. is a legal entity separate and distinct from its banking and nonbanking subsidiaries. Its principal sources of funds are cash dividends paid by those subsidiaries, investment income, and borrowings. Federal laws limit the amount of dividends or other capital distributions that a banking institution, such as the Company s two federal savings associations, can pay. Each of its two banking subsidiaries has a policy to remain well-capitalized and, accordingly, would not pay dividends to the extent payment of the dividend would result in it not being well-capitalized. In addition, the two federal savings associations must file a notice with the OTS at least 30 days before they can pay dividends to their parent companies. Refer to Note 19 to the Consolidated Financial Statements Regulatory Capital Requirements and Dividend Restrictions for a more detailed description of the limits on subsidiary bank dividends.

Capital Adequacy

Washington Mutual, Inc. is not currently subject to any regulatory capital requirements, but each of its subsidiary depository banking institutions is subject to OTS capital requirements. An institution s capital category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure, a tangible equity ratio measure, and certain other factors.

Federal law and regulations establish minimum capital standards. Under such standards federal savings associations are required to maintain a leverage ratio of core capital to adjusted total assets of at least 4.00%, a Tier 1 risk-based capital ratio of at least 4.00%, a total risk-based capital ratio of at least 8.00% and a tangible capital ratio of at least 1.50%. Federal law and regulations also establish five capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution is treated as well-capitalized if its ratio of total capital to risk-weighted assets is 10.00% or more, its ratio of Tier 1 capital to risk-weighted assets is 6.00% or more, its leverage ratio is 5.00% or more, and it is not subject to any federal supervisory order or directive to meet a specific capital level. In order to be adequately capitalized, an institution must have a total risk-based capital ratio of not less than 8.00%, a Tier 1 risk-based capital ratio of not less than 4.00%, and (unless it is in the most highly-rated category) a leverage ratio of not less than 4.00%. Any institution that is neither well-capitalized nor adequately capitalized will be considered undercapitalized. Any institution with a tangible equity ratio of 2.00% or less will be considered critically undercapitalized.

As of December 31, 2005 both of the Company s banking subsidiaries met all capital requirements to which they were subject and satisfied the requirements to be treated as well-capitalized institutions. See Note 19 to the Consolidated Financial Statements Regulatory Capital Requirements and Dividend Restrictions for an analysis of the regulatory capital of the Company.

The Company continues to actively follow the progress of the U.S. banking agencies and the Basel Committee on Banking Supervision in developing a new set of regulatory risk-based capital requirements. The Basel Committee on Banking Supervision is a committee established by the central bank governors of certain industrialized nations, including the United States. The new requirements are commonly referred to as Basel II or The New Basel Capital Accord. The Company is participating in efforts to refine these standards to ensure that they measure risk as precisely as possible within the framework of The New Basel Capital Accord, and is working to ensure that its internal measurement of credit risk, market risk, and

operational risk will comply with the new standards. The Company is also assessing the potential impacts The New Basel Capital Accord may have on its business practices as well as broader competitive effects within the industry.

Holding Company Status and Acquisitions

Washington Mutual, Inc. is a multiple savings and loan holding company, as defined by federal law, because it owns more than one savings association. However, Washington Mutual, Inc. is regulated as a unitary savings and loan holding company because the OTS deems its federal savings associations to have been acquired in supervisory transactions. Therefore, it is exempt from certain restrictions that would otherwise apply under federal law to the activities and investments of a multiple savings and loan holding company. These restrictions will apply to Washington Mutual, Inc. if either of its banking institutions fail to meet a qualified thrift lender test established by federal law. As of December 31, 2005, the Company s two banking subsidiaries were in compliance with qualified thrift lender standards.

Washington Mutual, Inc. may not acquire control of another savings association unless the OTS approves. Washington Mutual, Inc. may not be acquired by a company, other than a bank holding company, unless the OTS approves, or by an individual unless the OTS does not object after receiving notice. Washington Mutual, Inc. may not be acquired by a bank holding company unless the Board of Governors of the Federal Reserve System (the Federal Reserve) approves. In any case, the public must have an opportunity to comment on the proposed acquisition, and the OTS or Federal Reserve must complete an application review. Without prior approval from the OTS, Washington Mutual, Inc. may not acquire more than 5% of the voting stock of any savings institution that is not already one of its subsidiaries.

The Gramm-Leach-Bliley Act generally restricts any non-financial entity from acquiring Washington Mutual, Inc. unless such non-financial entity was, or had submitted an application to become, a savings and loan holding company as of May 4, 1999. Since Washington Mutual, Inc. was treated as a unitary savings and loan holding company prior to that date, Washington Mutual, Inc. may engage in non-financial activities and acquire non-financial subsidiaries.

Federal Home Loan Bank System

The primary purpose of the Federal Home Loan Banks (FHLBs) is to provide funding to their members for making housing loans as well as for affordable housing and community development lending. The FHLBs are generally able to make advances to their member institutions at interest rates that are lower than could otherwise be obtained by such institutions. The FHLB System consists of twelve regional FHLBs; each is federally chartered but privately owned by its member institutions. The Federal Housing Finance Board (Finance Board), a government agency, is generally responsible for regulating the FHLB System.

One of the Company s federal savings associations, WMB, currently is a member of the San Francisco FHLB. The other federal savings association, Washington Mutual Bank fsb (WMBfsb), is a member of the Seattle FHLB.

In June 2004, the Finance Board issued a regulation that required each FHLB to register a class of its equity securities with the Securities and Exchange Commission (SEC) by filing a Form 10 Registration Statement no later than June 30, 2005 and to ensure that the registration be declared effective no later than August 29, 2005. Upon becoming an SEC registrant, each FHLB is required to file quarterly, annual and supplemental financial disclosures with the Securities and Exchange Commission and to provide more public disclosure. The San Francisco FHLB filed a Registration Statement on June 30, 2005. The Seattle FHLB filed a Registration Statement with the SEC on June 30, 2005, but on August 26, 2005 filed to withdraw that Registration Statement and has not subsequently filed a new Registration Statement. The Seattle FHLB is reviewing certain issues related to derivatives accounting under Financial Accounting

Standards Board (FASB) Statement of Financial Accounting Standards (Statement) No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended, and expects to re-file a registration statement with the SEC as soon as these issues have been resolved.

As a condition of membership and as a condition of obtaining advances, members of a FHLB are required to purchase and hold certain amounts of equity securities of that FHLB. Effective May 18, 2005, the Seattle FHLB has suspended payment of dividends on equity securities and suspended repurchases of most of its equity securities. The Company cannot predict when the Seattle FHLB will begin to pay dividends on or repurchase its equity securities.

Congress is considering proposals which would establish a new regulator for the FHLB system, as well as for other housing government-sponsored enterprises. Washington Mutual cannot predict at this time which, if any, of these proposals may be adopted or what effect they would have on the business of the Company.

Deposit Insurance

The FDIC insures the deposits of each of the Company s banking subsidiaries to the applicable maximum in each institution, and such insurance is backed by the full faith and credit of the United States government. The FDIC administers two separate deposit insurance funds, the Bank Insurance Fund (the BIF) and the Savings Association Insurance Fund (the SAIF). The BIF is a deposit insurance fund for commercial banks and some federal and state-chartered savings banks. The SAIF is a deposit insurance fund for most savings associations. The Company s federal savings associations are members of the SAIF, but a small portion of WMB s deposits are insured through the BIF.

The FDIC has established a risk-based system for setting deposit insurance assessments. Under the risk-based assessment system, an institution s insurance assessments vary according to the level of capital the institution holds and the degree to which it is the subject of supervisory concern. During 2005, the assessment rate for both SAIF and BIF deposits ranged from zero to 0.27% of assessable deposits. The Company s banking subsidiaries qualified for the lowest rate on their deposits in 2005 and paid no deposit insurance assessments.

In February 2006, the President signed federal deposit insurance reform legislation. This legislation requires the FDIC to merge the BIF and the SAIF into a newly created Deposit Insurance Fund (DIF); increases the amount of deposit insurance coverage for retirement accounts; allows for deposit insurance coverage on individual accounts to be indexed for inflation starting in 2010; provides the FDIC more flexibility in setting and imposing deposit insurance assessments; and provides eligible institutions, such as the Company s banking subsidiaries, credits on future assessments.

The merger of the BIF and the SAIF is required to take place in the first half of 2006. Once the two funds are merged, the Company s banking subsidiaries will become members of the DIF. The Company s banking subsidiaries will be subject to the new assessment and credit provisions once the FDIC, sometime before November 6, 2006, promulgates regulations implementing these provisions.

Affiliate Transaction Restrictions

Washington Mutual s two banking subsidiaries are subject to, and comply with, the affiliate and insider transaction rules applicable to member banks of the Federal Reserve System as well as additional limitations imposed by the OTS. These provisions prohibit or limit a banking institution from extending credit to, or entering into certain transactions with, affiliates (such as Washington Mutual, Inc.), principal stockholders, directors and executive officers of the banking institution and its affiliates.

Federal Reserve, Consumer and Other Regulation

Numerous regulations promulgated by the Federal Reserve Board affect the business operations of the Company s banking subsidiaries. These include regulations relating to equal credit opportunity, electronic fund transfers, collection of checks, truth in lending, truth in savings and availability of funds.

Under Federal Reserve Board regulations, both of the Company s banking subsidiaries are required to maintain a reserve against their transaction accounts (primarily interest-bearing and noninterest-bearing checking accounts). Because reserves must generally be maintained in cash or in noninterest-bearing accounts, the effect of the reserve requirements is to increase an institution s cost of funds.

The Gramm-Leach-Bliley Act included provisions that give consumers new protections regarding the transfer and use of their nonpublic personal information by financial institutions. In addition, states are permitted under the Gramm-Leach-Bliley Act to have their own privacy laws, which may offer greater protection to consumers than the Gramm-Leach-Bliley Act. Numerous states in which the Company does business have enacted such laws.

The Bank Secrecy Act and the USA PATRIOT Act, which were enacted following the events of September 11, 2001, included numerous provisions designed to fight international money laundering and to block terrorist access to the U.S. financial system. Washington Mutual has established policies and procedures to ensure compliance with the provisions of the Bank Secrecy Act and the USA PATRIOT Act, and the impact of these Acts on the Company s operations has not been material.

Community Reinvestment Act

The Community Reinvestment Act (CRA) requires that the Company s banking subsidiaries ascertain and help meet the credit needs of the communities it serves, including low- to moderate-income neighborhoods, while maintaining safe and sound banking practices. The primary federal regulatory agency assigns one of four possible ratings to an institution s CRA performance and is required to make public an institution s rating and written evaluation. The four possible ratings of meeting community credit needs are outstanding, satisfactory, needs to improve, and substantial noncompliance. In the most recent examination results, the Company s two federal associations received an outstanding CRA rating from the OTS. The Company maintains a CRA public file that is available for viewing. The file includes copies of its most recent CRA Public Evaluations, descriptions of its products and services, delivery outlet information, and public comments.

In September 2001, Washington Mutual announced a ten-year $375 billion community commitment, effective January 2002. This commitment replaced prior ones made by the Company and the companies it acquired. As of December 31, 2005, the Company had exceeded its yearly targets for lending in low- to moderate-income neighborhoods and underserved market areas.

Regulatory Enforcement

The OTS and the FDIC may take regulatory enforcement actions against any of their regulated institutions that do not operate in accordance with applicable regulations, policies and directives. Proceedings may be instituted against any banking institution, or any institution-affiliated party, such as a director, officer, employee, agent, or controlling person, who engages in unsafe and unsound practices, including violations of applicable laws and regulations. Each of the OTS and the FDIC has authority under various circumstances to appoint a receiver or conservator for an insured institution that it regulates, to issue cease and desist orders, to obtain injunctions restraining or prohibiting unsafe or unsound practices, to revalue assets and to require the establishment of reserves. The FDIC has additional authority to terminate insurance of accounts, after notice and hearing, upon a finding that the insured institution is or has engaged in any unsafe or unsound practice that has not been corrected, is operating in an unsafe or unsound condition, or has violated any applicable law, regulation, rule, or order of, or condition imposed by the FDIC.

Regulation of Nonbanking Affiliates

As broker-dealers registered with the Securities and Exchange Commission and as members of the NASD (National Association of Securities Dealers), Inc., the Company s broker-dealer subsidiaries are subject to various regulations and restrictions imposed by those entities, as well as by various state authorities. As a registered investment advisor, WM Advisors is subject to various federal and state securities regulations and restrictions. The Company s subprime mortgage subsidiary, Long Beach Mortgage Company, is subject to various federal and state laws and regulations, including those relating to truth-in-lending, equal credit opportunity, fair credit reporting, real estate settlement procedures, debt collection practices and usury. The Company s insurance subsidiaries are subject to regulation by various state insurance regulators. Some of the Company s subsidiaries are subject to various state licensing and examination requirements.

Executive Officers

The following table sets forth certain information regarding the executive officers of Washington Mutual:

Executive Officers	Age	Capacity in Which Served	Employee of Company Since
Kerry K. Killinger	56	Chairman and Chief Executive Officer	1983
Thomas W. Casey	43	Executive Vice President and Chief Financial Officer	2002
Ronald J. Cathcart	53	Executive Vice President and Chief Enterprise Risk Officer	2005
Fay L. Chapman	59	Senior Executive Vice President and General Counsel	1997
Daryl D. David	51	Executive Vice President, Human Resources	2000
Debora D. Horvath	51	Executive Vice President and Chief Information Officer	2004
Kenneth E. Kido	48	Executive Vice President and Acting President, Retail Banking	2001
J. Benson Porter	40	Executive Vice President and Chief Administrative Officer	1996
Stephen J. Rotella	52	President and Chief Operating Officer	2005
David C. Schneider	40	Executive Vice President and President, Home Loans	2005
John F. Woods	41	Senior Vice President and Controller	2005

Mr. Killinger established the Executive Committee in 1990 to facilitate and coordinate decision making and communication among the most senior executive officers of the Company who, as a committee, determine the Company s strategic direction. The executive officers serving on this committee are indicated below.

Mr. Killinger is Chairman and Chief Executive Officer of Washington Mutual. He was named President and a Director in 1988, Chief Executive Officer in 1990 and Chairman in 1991. He served as President through 2004. He has been a member of the Executive Committee since its formation in 1990.

Mr. Casey is Executive Vice President, Chief Financial Officer and a member of the Executive Committee of Washington Mutual. He oversees all aspects of Washington Mutual s corporate finance, strategic planning and investor relations functions. Prior to joining Washington Mutual, Mr. Casey was with GE Capital Corp. from 1992 through 2002 where he held advising, controllership and analyst positions prior to becoming a Vice President of GE and Senior Vice President and Chief Financial Officer of GE Financial Assurance in 1999.

Mr. Cathcart joined the Company in December 2005 as Executive Vice President and Chief Enterprise Risk Officer and became a member of the Executive Committee at that time. He is responsible for overseeing the credit, market and operational risk functions for the company. Prior to joining Washington Mutual, he served as Executive Vice President of Retail Risk Management at the Canadian Imperial Bank of Commerce (CIBC) from 2002 to 2005. Prior to joining CIBC, Mr. Cathcart served in a variety of risk management positions at Bank One from 1999 to 2002, including Executive Vice President, Retail Risk Management.

Ms. Chapman has served as the Company s General Counsel and Senior Executive Vice President since 1999. She became Executive Vice President, General Counsel and a member of the Executive Committee in 1997. Prior to joining Washington Mutual, she was a partner at the Seattle law firm of Foster Pepper & Shefelman PLLC from 1979 to 1997.

Mr. David joined Washington Mutual in 2000 as Executive Vice President, Human Resources. He is responsible for talent acquisition, organizational capabilities, leadership development and rewards and benefits. Mr. David became a member of the Executive Committee in 2001. Previously he served as Vice President of Strategic Growth and Human Resources at Amazon.com from 1999 to 2000. He also served in executive human resource positions with Sanga International, Magnetek, Inc., and Allied Signal from 1992 to 1999.

Ms. Horvath joined Washington Mutual in 2004 as Executive Vice President and Chief Information Officer and became a member of the Executive Committee at that time. She is responsible for overseeing the Company s enterprise-wide technology efforts. Prior to joining Washington Mutual, she served as Senior Vice President and Chief Information Officer with GE Capital Great Northern Annuity, GE Financial Assurance and GE Insurance from 1993 to 2004.

Mr. Kido is Executive Vice President and Acting President, Retail Banking. He manages all aspects of consumer lending and deposit product management and operations and is responsible for the management and operations of over 2,100 financial centers in 16 states including the Company s small business operations. He became a member of the Executive Committee in 2005. Mr. Kido joined Washington Mutual in July 2001 after spending 24 years with Bank of America, most recently as head of their Consumer Card Division.

Mr. Porter has served as Executive Vice President and Chief Administrative Officer since 2004. In this role, he oversees teams that provide company-wide support for sourcing and purchasing, corporate communications, operational excellence initiatives, corporate property management, community affairs, the enterprise-wide call centers and community lending and investment. Mr. Porter joined Washington Mutual in 1996 and became a member of the Executive Committee in 2004.

Mr. Rotella became President and Chief Operating Officer of Washington Mutual in January 2005 and became a member of the Executive Committee at that time. He is responsible for overseeing the Company s retail, home loans, credit card and commercial lines of business, the technology group and marketing, as well as day-to-day corporate administration. Prior to joining Washington Mutual, he was an Executive Vice President with JPMorgan Chase and served on its executive committee from 2001 to 2004. In addition, he was the Chief Executive Officer of Chase Home Finance from 2001 to 2004 and its Chief Operating Officer from 1998 to 2001.

Mr. Schneider joined the Company in July 2005 as Executive Vice President and President, Home Loans and became a member of the Executive Committee at that time. He oversees all aspects of the Company s home loans business including prime mortgage lending, mortgage banker finance, Long Beach Mortgage Company and specialty mortgage finance. Prior to joining Washington Mutual, Mr. Schneider served as President and Chief Operating Officer of CitiMortgage, Inc. Prior to joining CitiMortgage in April 2001, he served as Executive Vice President of Retail Banking for Old Kent Financial Corporation from 1998 to 2001.

Mr. Woods joined the Company in December 2005 as Senior Vice President and Controller. He serves as the Company s principal accounting officer. Prior to joining the Company, Mr. Woods served in various positions at Freddie Mac including Senior Vice President, Principal Accounting Officer and Corporate Controller. Prior to joining Freddie Mac in 2002, Mr. Woods was a partner at Arthur Andersen in its financial services audit and consulting practices.

Properties

The Company s primary executive and business segment headquarters are located at 1201 Third Avenue, Seattle, Washington 98101. The Company leases approximately 400,000 square feet at this location and an additional 700,000 square feet in other downtown Seattle locations for administrative functions.

The Company, in a joint venture with the Seattle Art Museum, is constructing a new headquarters building in downtown Seattle. On completion of the building, the Company will own approximately 900,000 square feet and will lease from the Seattle Art Museum an additional 250,000 square feet for a period of up to 25 years. The lessor has the right to cancel the lease, in whole or in part, at any time after the tenth year of the lease. Occupancy and the term of the lease are expected to commence concurrently in 2006; accordingly, certain of the leases in downtown Seattle locations will not be renewed when their terms expire, as the majority of those occupants will move to the new headquarters building.

As of December 31, 2005, the Company or its subsidiaries owned or leased property in 38 states for 2,140 retail banking stores, 487 lending stores and centers and 323 administrative and other offices. Administrative facilities involve the ownership or leasing of approximately 2.4 million square feet in California, 1.2 million square feet in Texas, 900,000 square feet in Florida and 500,000 square feet in Illinois.

Legal Proceedings

In the ordinary course of business, the Company and its subsidiaries are routinely defendants in or parties to a number of pending and threatened legal actions and proceedings, including actions brought on behalf of various classes of claimants. In certain of these actions and proceedings, claims for substantial monetary damages are asserted against the Company and its subsidiaries. Certain of these actions and proceedings are based on alleged violations of consumer protection, banking and other laws.

In July 2004, the Company and a number of its officers were named as defendants in a series of cases alleging violations of Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), Rule 10b-5 thereunder and Section 20(a) of the Exchange Act. By stipulation, those cases were consolidated into a single case currently pending in the U.S. District Court for the Western Division of Washington. *South Ferry L.P. #2 v. Killinger et al.*, No. CV04-1599C (W.D. Wa., Filed Jul. 19, 2004) (the Securities Action). In brief, the plaintiffs in the Securities Action allege, on behalf of a putative class of purchasers of Washington Mutual, Inc., securities from April 15, 2003, through June 28, 2004, that in various public statements the defendants purportedly made misrepresentations and failed to disclose material facts concerning, among other things, alleged internal systems problems and hedging issues.

The defendants moved to dismiss the Securities Action on May 17, 2005. After briefing, but without oral argument, the Court on November 17, 2005, denied the motion in principal part; however, the Court dismissed the claims against certain of the individual defendants, dismissed claims pleaded on behalf of sellers of put options on Washington Mutual stock, and concluded that the plaintiffs could not rely on supposed violations of accounting standards to support their claims. The remaining defendants subsequently moved for reconsideration or, in the alternative, certification of the opinion for interlocutory appeal to the United States Court of Appeals for the Ninth Circuit. The District Court denied the motion for reconsideration, but on March 6, 2006, granted the motion for certification. The defendants will now move the Ninth Circuit to have the appellate court accept the case for interlocutory review of the District Court s original order denying the motion to dismiss. The District Court stayed further proceedings before it pending the outcome of the defendant s motion to the Ninth Circuit.

On November 29, 2005, 12 days after the Court denied the motion to dismiss the Securities Action, a separate plaintiff filed in Washington State Superior Court a derivative shareholder lawsuit purportedly asserting claims for the benefit of the Company. The case was removed to federal court, where it is now

pending. *Lee Family Investments, by and through its Trustee W.B. Lee, Derivatively and on behalf of Nominal Defendant Washington Mutual, Inc. v. Killinger et al.*, No. CV05-2121C (W.D. Wa., Filed Nov. 29, 2005) (the Derivative Action). The defendants in the Derivative Action include those individuals remaining as defendants in the Securities Action, as well as those of the Company s current independent directors who were directors at any time from April 15, 2003, through June 2004. The allegations in the Derivative Action mirror those in the Securities Action, but seek relief based on claims that the independent director defendants failed properly to respond to the misrepresentations alleged in the Securities Action and that the filing of that action has caused the Company to expend sums to defend itself and the individual defendants and to conduct internal investigations related to the underlying claims. The defendants have not yet responded to the complaint in the Derivative Action.

See Note 15 to the Consolidated Financial Statements Commitments, Guarantees and Contingencies for a further discussion of pending and threatened litigation action and proceedings against the Company.

Submission of Matters to a Vote of Security Holders

None.

PART II

Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Washington Mutual s common stock trades on The New York Stock Exchange under the symbol WM. As of February 28, 2006, there were 992,254,791 shares issued and outstanding (including 6 million shares held in escrow) held by 61,025 shareholders of record. The information regarding high and low quarterly sales prices of the Company s common stock, and the quarterly cash dividends declared thereon, is set forth in this Form 10-K in the Quarterly Results of Operations table included under Supplementary Data on page 176 and is expressly incorporated herein by reference.

The table below represents share repurchases made by the Company for the quarter ended December 31, 2005. Management may engage in future share repurchases as liquidity conditions permit and market conditions warrant.

Issuer Purchases of Equity Securities	Total Number of Shares (or Units) Purchased(1)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(2)	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 1, 2005 to October 31, 2005	18,932,665	$ 42.23	18,932,000	84,500,000
November 1, 2005 to November 30, 2005	300,386	44.61		84,500,000
December 1, 2005 to December 31, 2005	711	43.63		84,500,000
Total	19,233,762	42.26	18,932,000	84,500,000

(1) In addition to shares repurchased pursuant to the Company s publicly announced repurchase program, this column includes shares acquired under equity compensation arrangements with the Company s employees and directors.

(2) Effective July 15, 2003, the Company adopted a share repurchase program approved by the Board of Directors (the 2003 Program). Under the 2003 Program, the Company was authorized to repurchase up to 100 million shares of its common stock, as conditions warranted. On October 18, 2005, the Company discontinued the 2003 Program and adopted a new share repurchase program approved by the Board of Directors (the 2005 Program). The Company had repurchased 64,842,794 shares under the 2003 Program, of which 3,432,000 were repurchased during the fourth quarter of 2005, prior to its discontinuance. Under the 2005 Program, the Company is authorized to repurchase up to 100 million shares of its common stock as conditions warrant and had repurchased 15,500,000 shares under this program as of December 31, 2005.

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

Restatement of Financial Statements

Subsequent to the original filing of the Company s Annual Report on Form 10-K, the Company completed a comprehensive review and reconciliation of its current and deferred income tax accounts and concluded that a $337 million reduction to retained earnings was necessary, representing cumulative adjustments to net income recorded in prior periods up to and including 2001. No adjustments were made to net income or earnings per share for any of the periods from 2002 through June 30, 2006. The adjustments reflect corrections to the tax accounting records related to matters occurring prior to 2002 at the Company and predecessor companies, including H.F. Ahmanson & Co., Great Western Financial Corp. and American Savings Bank, which the Company acquired in the late 1990s. The adjustments arose primarily from inadequate tax records, delays in reconciling tax accounts and errors in recording the impact of certain tax payments and the income tax expense of the Company during those years. Accordingly, these adjustments affected the balance of retained earnings and certain tax accounts at December 31, 2001 and each period thereafter. Refer to Note 2 to the Consolidated Financial Statements Restatement of Financial Statements for further information regarding the effects of this restatement on the Company s Consolidated Statements of Financial Condition at December 31, 2005 and 2004. The accompanying Management s Discussion and Analysis gives effect to the restatement.

Acquisition of Providian Financial Corporation

On October 1, 2005 the Company completed its acquisition of Providian Financial Corporation in a stock and cash merger valued at approximately $5.8 billion. For each share of Providian common stock, Providian stockholders received .4005 shares of Washington Mutual common stock and $2.00 in cash. As a result of this acquisition, the Company now ranks as the eighth largest among all credit card issuers. The card services activities of the Company are conducted through a new operating segment entitled Washington Mutual Card Services (Card Services).

Subsequent Accounting Revision

Subsequent to furnishing the Company s fourth quarter 2005 earnings release on Form 8-K on January 18, 2006, the Company made a reclassification change to the Consolidated Statements of Income, included within this Annual Report on Form 10-K, with regard to the presentation of credit card receivables that were sold in the fourth quarter of 2005. This change was made to conform Providian s historical accounting practice for such sales to Washington Mutual s accounting policy for transactions of this nature. When loans that were originally recorded in the Company s held for investment portfolio are subsequently sold, the Company s policy results in the reduction of their cost basis by the amount of the loan loss allowance allocable to the sold loans. Providian s practice, by contrast, did not consider the allocable allowance when computing gain on credit card sales. Providian s historical accounting practice was applied for reporting purposes in the Company s Form 8-K dated January 18, 2006. This change resulted in an increase of $96 million to the fourth quarter credit card gain on sale (which is reported in the Consolidated Statements of Income under the noninterest income caption Revenue from sales and servicing of consumer loans) and a corresponding increase to the provision for loan and lease losses. This change had no effect on net income.

Discontinued Operations

In January 2004, the Company sold its subsidiary, Washington Mutual Finance Corporation, for approximately $1.30 billion in cash. Accordingly, this former subsidiary is presented in this report as a discontinued operation with its results of operations and cash flows segregated from the Company s results of continuing operations for the affected periods presented on the Consolidated Statements of Income,

Cash Flows and Notes to the Consolidated Financial Statements as well as the tables presented herein, unless otherwise noted.

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 submits under the Securities Exchange Act of 1934.

In reaching the conclusion that disclosure controls and procedures were effective, management had considered the potential financial impact of control deficiencies associated with the matters giving rise to the restatement described in Note 2 to the Consolidated Financial Statements on page 113. Management believes this restatement is immaterial and was not the result of a material weakness in the Company s internal control over financial reporting. Accordingly, management has not changed its conclusion described above that the Company s disclosure controls and procedures were designed and operating effectively as of December 31, 2005.

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 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, and changes its internal control over financial reporting as needed to maintain their effectiveness, correcting any deficiencies, as needed, in order to ensure the continued effectiveness of the Company s internal controls. The Company s internal control over financial reporting changed when the Company acquired Providian Financial Corporation on October 1, 2005, to include the key controls inherent within the credit card operations it acquired. Except for this change, there have not been any other changes in the Company s internal control over financial reporting during the fourth quarter of 2005 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 89.

Overview

Net income for 2005 was $3.43 billion, or $3.73 per diluted share, an increase from $2.88 billion, or $3.26 per diluted share for 2004. Included in earnings for 2004 was an after-tax gain of $399 million, or 45 cents per diluted share, from the first quarter sale and disposal of the Company s former consumer finance subsidiary, Washington Mutual Finance Corporation.

Net interest income was $7.89 billion in 2005, compared with $7.12 billion in 2004. The increase was primarily due to growth in the average total loan portfolio and loans held for sale, which collectively increased by 16% during 2005. Largely offsetting the growth in interest-earning assets was contraction in the net interest margin. The net interest margin in 2005 was 2.67%, a decline of 15 basis points from 2004. The decrease in the net interest margin was due to an increase in the cost of the Company s interest-bearing liabilities, which was driven by continuous increases in short-term interest rates since June of 2004.

As the U.S. economy rebounded in 2004 and 2005 from the downturn in the early part of the decade, the Federal Reserve Board initiated a series of 25 basis point increases in the targeted federal funds rate. This benchmark interest rate has increased from 1.00% in the second quarter of 2004 to 4.50% at the end of January 2006. These increases gradually shifted the Federal Reserve s monetary policy from a position that provided a stimulus effect on the domestic economy towards a more neutral fiscal policy that reduces the potential threat of inflation. Although the Federal Reserve has not stated that a 4.50% rate represents a position of neutrality, it did recently imply, for the first time since the current series of increases began, that the current rate is no longer at a level that would stimulate economic expansion. Accordingly, the current rate appears to be close to entering the Federal Reserve s target zone for fiscal policy neutrality. Until rates move into that zone, additional increases are likely. Since the Company s adjustable-rate home loans and securities reprice to current market rates more slowly than its wholesale borrowing sources, the Company expects the net interest margin will continue to be pressured until the federal funds rate stabilizes.

Partially mitigating the disparity in repricing speeds is the growth in home equity line of credit balances, which have repricing frequencies that are more closely aligned with the faster repricing behavior of the Company s wholesale borrowings. The average balance of home equity lines of credit was $36.14 billion in 2005, an increase of $9.71 billion, or 37% from 2004, while the yield on this portfolio increased from 4.23% to 5.85%. Additionally, the margin benefited from the fourth quarter addition of the credit card portfolio acquired from Providian Financial Corporation and from the partial restructuring of the available-for-sale securities portfolio in the first quarter of 2005, which resulted in the sale of approximately $3 billion of lower-yielding debt securities and the subsequent purchase of securities with comparatively higher yields.

Noninterest income in 2005 was $5.74 billion, an increase of $1.13 billion from 2004. The increase was largely due to consumer loan sales and servicing income of $413 million and credit card fee income of $139 million, all of which resulted from the Company s new Card Services segment, and improved revenues from the Company s home loan banking operations. At December 31, 2005, total managed credit card receivables were approximately $19.96 billion, an increase of nearly $700 million during the fourth quarter of 2005. A significant portion of this increase was the result of cross-selling credit card products to the Company s retail banking customer base.

Revenue from sales and servicing of home mortgage loans, including the effects of all MSR risk management instruments, was $1.79 billion in 2005, an increase from $1.47 billion in 2004. The increase was primarily due to higher levels of gains from the sale of mortgage loans and originated mortgage backed securities, net of gains and losses from risk management instruments. This increase was fostered by the strength of the U.S. housing market, which fueled strong customer demand for fixed-rate mortgages and the Company s Option ARM portfolio. In particular, the sustained liquidity of the Option ARM product in the secondary market enabled the Company to sell approximately $48.13 billion of Option ARM volume during 2005, compared with $14.12 billion in 2004. The Company also sells substantially all of its fixed-rate and medium-term adjustable-rate home loan volume.

As the yield curve continued to flatten throughout 2005 (and ended the year virtually flat), the interest rate differential between short-term adjustable-rate loans, such as the Option ARM, and fixed-rate loans continued to compress, which increases the desirability of fixed-rate loan products. Accordingly, short-term adjustable-rate loans, as a percentage of total home loan volume, declined from 39% in the fourth quarter of 2004 to 26% in the final quarter of 2005, while fixed-rate loans, as a percentage of total home loan volume, increased from 32% to 44% during the same periods.

The Company recorded a provision for loan and lease losses of $316 million in 2005, compared with a provision of $209 million in 2004. Reflecting the higher risk profile associated with the unsecured, higher-yielding lending activities conducted by Card Services, the 2005 provision included $195 million that was

related to the credit card portfolio in the fourth quarter. A relatively benign credit risk environment for the Company s real estate secured lending activities existed through most of 2005, reflecting the positive effects of a low mortgage interest rate environment, stable or appreciating housing prices in most of the Company s markets, and a relatively low national unemployment rate.

Depositor and other retail banking fees were $2.19 billion in 2005, a 10% increase from 2004. The growth was driven by strong increases in the number of retail checking accounts as well as an increase in debit card interchange and ATM-related income. The number of retail checking accounts at December 31, 2005 totaled approximately 9.9 million, compared with approximately 9.0 million at December 31, 2004, an increase of over 900,000 accounts. Total retail transaction accounts, which include checking, money market and savings accounts, increased by nearly 1.5 million in 2005.

The Company continues to grow its retail banking business by opening new stores and enhancing its products and services. The Company opened 210 new stores in 2005, and has established a target of opening between 150 and 200 new stores within its existing markets during 2006. Although the Company expects total noninterest expense to be higher in 2006 as a result of the continuing expansion of the retail banking franchise and the full-year effect of absorbing the Card Services Group into the Company s cost structure, those efforts will also be accompanied by rigorous expense management discipline and the implementation of operational efficiencies and productivity improvements, including the redeployment of certain back-office support operations to more cost-effective labor markets and the consolidation of other administrative support facilities.

Critical Accounting Estimates

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States of America requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the Consolidated 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. In some instances, different estimates and assumptions could have been reasonably used to supplant those that were applied. Had those alternative estimates and assumptions been applied, the differences that may result from those alternative applications could have a material effect on the financial statements.

The Company has identified three accounting estimates that, due to the judgments and assumptions inherent in those estimates, and the potential sensitivity of its Consolidated Financial Statements to those judgments and assumptions, are critical to an understanding of its Consolidated Financial Statements. These estimates are: the fair value of certain financial instruments and other assets; derivatives and hedging activities; and the allowance for loan and lease losses and contingent credit risk liabilities.

Management has discussed the development and selection of these critical accounting estimates with the Company s Audit Committee. The Company believes that the judgments, estimates and assumptions used in the preparation of its Consolidated Financial Statements are appropriate given the facts and circumstances as of December 31, 2005. 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: certain retained interests from securitization activities (which are classified as trading assets), available-for-sale securities and derivatives.

Mortgage servicing rights and loans held for sale are recorded at the lower of carrying value or fair value. For those that qualify as hedged items under fair value hedge accounting, their changes in fair value are recognized in earnings and offset the changes in fair value of derivatives used as hedge accounting instruments.

Fair value is defined as the amount at which a financial instrument could be exchanged in a hypothetical transaction between willing, unrelated parties, other than in a forced or liquidation sale. Generally, for assets that are reported at fair value, the Company uses quoted market prices or internal valuation models that utilize market data inputs and other assumptions, such as loan prepayment speeds, forward interest rate yield curves, market volatilities and pricing spreads to determine their fair values. The degree of management judgment involved in determining 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, if any, subjectivity is applied when determining the instrument s fair value. When observable market prices and data do not exist, significant management judgment is necessary to estimate fair value. In those cases, small changes in assumptions could result in significant changes in valuation.

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

MSRs and certain other retained interests from securitization activities do not trade in an active, open market with readily quoted prices. Although sales do occur from time to time, the terms of such sales are generally not readily available. Consequently, the Company estimates the fair value of MSRs and certain other retained interests in securitization activities utilizing internal discounted cash flow models.

For MSRs, the discounted cash flow model calculates the present value of the expected future net cash flows of the servicing portfolio based on various assumptions, such as estimated future servicing costs, expected servicing portfolio prepayment speeds and discount rates that are commensurate with the risk profile of the serviced assets. This model is highly sensitive to changes in certain assumptions. Different anticipated prepayment speeds, in particular, can result in substantial changes in the estimated fair value of MSR. If actual prepayment experience differs from the anticipated rates used in the Company s model, this difference would likely result in a material change in MSR fair value. While the Company s model estimates a value, the specific value used is based on a variety of market-based factors, such as documented observable data and anticipated changes in prepayment speeds. The reasonableness of management s assumptions about these factors is evaluated through quarterly independent broker surveys. Independent appraisals of the fair value of the servicing portfolio are obtained periodically, but not less frequently than quarterly, and are used by management to evaluate the reasonableness of the fair value conclusions. 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 . Key economic assumptions and the sensitivity of MSR fair value to immediate changes in those assumptions are described in Note 7 to the Consolidated Financial Statements Mortgage Banking Activities.

For other retained interests in securitization activities (such as interest-only strips and residual interests) the discounted cash flow model used in determining fair value utilizes projections of expected cash flows that are greatly influenced by anticipated prepayment speeds and, in some cases, expected net credit losses or finance charges related to the securitized assets. 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 Trading assets income (loss) and on 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 are similar to those that will be collateralized by such loans. If market prices are not readily available, fair value is based on a discounted cash flow model, which takes into account prepayment factors and the degree of credit risk associated with the loans and the estimated effects of changes in market interest rates. When the estimated fair value of loans held for sale is lower than their carrying value or, for those that achieve fair value hedge accounting under Statement No. 133, as amended, when the estimated fair value is greater than their carrying value, a valuation adjustment that accounts for this difference is reported on the Consolidated Statements of Income as a component within the noninterest income caption Revenue from sales and servicing of home mortgage loans. Valuation adjustments for consumer loans held for sale are recorded under the noninterest income caption Revenue from sales and servicing of consumer loans.

Goodwill Impairment

Under FASB Statement No. 142, *Goodwill and Other Intangibles,* 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). 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 to 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 values 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.

Goodwill was not impaired as of December 31, 2005 or December 31, 2004, nor was any goodwill written off during the years ended December 31, 2005, 2004 and 2003. For additional information regarding the carrying values of goodwill by operating segment, see Note 8 to the Consolidated Financial Statements Goodwill and Other Intangible Assets.

Other Intangible assets

As part of a business combination accounted for under the purchase method, the Company must record all acquired assets and liabilities at fair value as of the acquisition date. Acquired assets include any identified intangible assets, such as purchased credit card relationships or core deposit intangibles. The fair value of those intangible assets usually is determined based on a discounted cash flow model that considers the expected net cash inflows resulting from those intangible relationships. If the intangible asset has a determinable finite life, the asset is amortized through earnings over its estimated life. Such amortization expense generally is recognized in the Consolidated Statements of Income under the noninterest expense

caption, Other Expense. For additional information regarding other intangible assets, see Note 8 to the Consolidated Financial Statements Goodwill and Other Intangible Assets.

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 on 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 within 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.

The determination of whether a derivative qualifies for hedge accounting requires judgment about the application of Statement No. 133, as amended. Statement No. 133, as amended, requires contemporaneous documentation of the Company s hedge relationships. Such documentation includes the nature of the risk being hedged, the identification of the asset or cash flow, or the group of assets or cash flows, that share the risk exposure that is designated as being hedged (i.e., the hedged item), 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 effectiveness assessment 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 documentation and assessment of effectiveness are not considered to be adequate to achieve hedge accounting treatment, the derivative is treated as a free-standing risk management instrument.

Allowance for Loan and Lease Losses and Contingent Credit Risk Liabilities

Allowance for loan and lease losses

The allowance for loan and lease losses represents management s estimate of incurred credit losses inherent in the Company s loan and lease portfolios as of the balance sheet date. The estimation of the allowance is based on a variety of factors, including past loan loss experience, the current credit profile of the Company s borrowers, adverse situations that have occurred that may affect the borrowers ability to repay, the estimated value of underlying collateral, the interest rate climate as it affects adjustable-rate loans and general economic conditions. Determining the adequacy 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 and lease losses in future periods.

The allowance for loan and lease losses is reported within the Consolidated Statements of Financial Condition and the provision for loan and lease losses is reported within 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 but retains credit risk exposure on those loans. When loans are sold with retained credit risk provisions attached to the sale, the Company commits to stand ready to perform, if the loan defaults, by making payments to remedy the default or repurchasing the loan. The Company also sells loans without retained credit risk that it may be required to repurchase for violation of a representation or warranty made in connection with the sale of the loan that has a material adverse effect on the value of the loan, or if the Company agreed to repurchase the loan in the event of a first payment or early payment default. When a loan sold to an investor without retained credit risk fails to perform according to its contractual terms, the investor will typically review the loan file to search for errors that 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 loan s sale, 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.

In 2004 and 2005, the Company s Long Beach Mortgage Company subsidiary engaged in whole loan sale transactions of originated subprime loans in which it agreed to repurchase from the investor each early payment default loan at a price equal to the loan s face value plus the amount of any premium paid by the investor. An early payment default occurs when the borrower fails to make the first post-sale payment due on the loan by a contractually specified date. Usually when such an event occurs, the fair value of the loan at the time of its repurchase is lower than the face value. In the fourth quarter of 2005, the Company experienced increased incidents of repurchases of early payment default loans sold by Long Beach Mortgage Company and this trend is expected to continue in the first part of 2006.

Reserves are established for the Company s exposure to these contingent credit risk liabilities in the aforementioned circumstances when it becomes probable that a loss has been incurred and the amount can be reasonably estimated. Throughout the life of these contingent credit risk 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. Contingent credit risk liabilities are recorded within other liabilities on the Consolidated Statements of Financial Condition, and losses are recorded on the Consolidated Statements of Income under the noninterest income caption Revenue from sales and servicing of home mortgage loans.

Recently Issued Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued a revised version of the original Statement of Financial Accounting Standards (Statement) No. 123, *Accounting for Stock-Based Compensation*. Statement No. 123R, *Share-Based Payment*, supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. This Statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This Statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair value-based measurement method in accounting for share-based payment transactions with employees, except for equity instruments held by employee stock ownership plans. Effective January 1, 2003 and in accordance with the transitional guidance of Statement No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the Company elected to prospectively apply the fair value method of accounting for stock-based awards granted subsequent to December 31, 2002. The Company will prospectively apply Statement No. 123R to its financial statements as of January 1, 2006. However, as the Company has already adopted Statement No. 148 and substantially

all stock-based awards granted prior to its adoption have fully vested as of December 31, 2005, Statement No. 123R will not have a significant effect on the Consolidated Statements of Income or the Consolidated Statements of Financial Condition.

In March 2005, Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 107 (SAB 107) was issued, which expresses views of the staff regarding the interaction between Statement No. 123R, *Share-Based Payment*, and certain SEC rules and regulations and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. The Company will consider the guidance provided by SAB 107 as part of its adoption of Statement No. 123R.

In May 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3.* This Statement replaces APB Opinion No. 20, *Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements,* and changes the requirements for the accounting and reporting of a change in accounting principle. This Statement requires changes in accounting principles to be retrospectively applied to the prior periods presented in the financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement applies to all voluntary changes in accounting principles and also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This Statement also carries forward, without substantive change, the provisions for the correction of an error from APB Opinion No. 20. Statement No. 154 is effective for accounting changes and corrections of errors made after December 31, 2005. The Company does not expect the application of this Statement to have a significant effect on the Consolidated Statements of Income or the Consolidated Statements of Financial Condition.

In February 2006, the FASB issued Statement No. 155, *Accounting for Certain Hybrid Financial Instruments.* This Statement amends Statements No. 133, *Accounting for Derivative Instruments and Hedging Activities and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* to simplify and make more consistent the accounting for certain financial instruments. This Statement permits fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided that the whole instrument is accounted for on a fair value basis and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. This Statement also allows a qualifying special purpose entity to hold a derivative financial instrument that pertains to a beneficial interest. Statement No. 155 is effective for all of the Company s financial instruments acquired or issued after December 31, 2006. Earlier adoption is permitted as of the beginning of an entity s fiscal year, provided the entity has not yet issued financial statements, including financial statements for any interim period for that fiscal year. The Company is currently evaluating the impact this guidance will have on the Consolidated Statements of Income or the Consolidated Statements of Financial Condition.

Five-Year Summary of Selected Financial Data

	December 31, 2005	2004	2003	2002	2001
	(in millions, except per share amounts)				
Income Statement Data (for the year ended)					
Net interest income	$ 7,886	$ 7,116	$ 7,629	$ 8,129	$ 6,492
Provision for loan and lease losses	316	209	42	404	426
Noninterest income	5,738	4,612	5,850	4,469	3,176
Noninterest expense	7,870	7,535	7,408	6,188	4,416
Net income	3,432	2,878	3,880	3,861	3,038
Basic earnings per common share(1):					
Income from continuing operations	3.84	2.88	4.20	4.01	3.50
Income from discontinued operations, net		0.46	0.09	0.08	0.07
Net income	3.84	3.34	4.29	4.09	3.57
Diluted earnings per common share(1):					
Income from continuing operations	3.73	2.81	4.12	3.94	3.44
Income from discontinued operations, net		0.45	0.09	0.08	0.07
Net income	3.73	3.26	4.21	4.02	3.51
Dividends declared per common share(1)	1.90	1.74	1.40	1.06	0.90
Balance Sheet Data (at year end)					
Securities	$ 24,659	$ 19,219	$ 36,707	$ 43,905	$ 58,233
Loans held for sale	33,582	42,743	20,837	39,623	27,574
Loans held in portfolio	229,632	207,071	175,150	143,028	126,396
Mortgage servicing rights	8,041	5,906	6,354	5,341	6,241
Goodwill	8,298	6,196	6,196	6,213	2,116
Assets	343,573	307,581	275,178	268,225	242,468
Deposits	193,167	173,658	153,181	155,516	106,946
Securities sold under agreements to repurchase	15,532	15,944	28,333	16,717	39,447
Advances from Federal Home Loan Banks	68,771	70,074	48,330	51,265	61,072
Other borrowings	23,777	18,498	15,483	14,712	9,925
Stockholders equity	27,279	20,889	19,405	19,724	13,688
Supplemental Data					
Loan volume:					
Home loans:					
Adjustable rate	$ 95,114	$ 103,305	$ 99,899	$ 84,627	$ 37,224
Fixed rate	78,118	77,723	263,604	180,745	108,105
Specialty mortgage finance(2)	34,490	31,334	20,678	14,077	10,333
Total home loan volume	207,722	212,362	384,181	279,449	155,662
Total loan volume	261,157	266,733	432,245	309,419	172,951

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(1) Restated for all stock splits.

(2) Represents purchased subprime loan portfolios and mortgages originated by Long Beach Mortgage Company.

Ratios and Other Supplemental Data

	Year Ended December 31, 2005	2004	2003
	(dollars in millions, except per share amounts)		
Profitability			
Return on average assets(1)	1.05 %	1.01 %	1.37 %
Return on average common equity(1)	14.84	14.26	19.17
Net interest margin	2.67	2.82	3.11
Efficiency ratio(2)(3)	57.76	64.25	54.96
Asset Quality			
Nonaccrual loans(4)(5)	$ 1,686	$ 1,534	$ 1,626
Foreclosed assets(4)	276	261	311
Total nonperforming assets(4)(5)	1,962	1,795	1,937
Nonperforming assets/total assets(4)(5)	0.57 %	0.58 %	0.70 %
Restructured loans(4)	$ 22	$ 34	$ 111
Total nonperforming assets and restructured loans(4)(5)	1,984	1,829	2,048
Allowance for loan and lease losses(4)	1,695	1,301	1,250
Allowance as a percentage of total loans held in portfolio(4)	0.74 %	0.63 %	0.71 %
Net charge-offs	$ 244	$ 135	$ 309
Capital Adequacy(4)			
Stockholders equity/total assets	7.94 %	6.79 %	7.05 %
Tangible equity(6)/total tangible assets(6)	5.62	4.94	5.16
Estimated total risk-based capital/risk-weighted assets(7)	10.80	11.20	10.74
Per Common Share Data			
Number of common shares outstanding at end of period (in thousands)	993,914	874,262	880,986
Common stock dividend payout ratio	49.48 %	52.10 %	32.63 %
Book value per common share(4)(8)	$ 27.61	$ 24.06	$ 22.18
Market prices:			
High	44.54	45.28	46.55
Low	36.92	37.63	32.98
Year end	43.50	42.28	40.12

(1) Includes income from continuing and discontinued operations.

(2) Based on continuing operations.

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

(4) As of year end.

(5) Excludes nonaccrual loans held for sale.

(6) Excludes unrealized net gain/loss on available-for-sale securities and derivatives, goodwill and intangible assets, but includes MSR. These adjustments are applied to both the numerator and the denominator.

(7) Estimate of what the total risk-based capital ratio would be if Washington Mutual, Inc. were a bank holding company that is subject to Federal Reserve Board capital requirements.

(8) Excludes 6 million shares held in escrow at December 31, 2005, 2004 and 2003.

Earnings Performance from Continuing Operations

Net Interest Income

For 2005, net interest income increased $770 million, or 11%, compared with 2004. The increase was largely due to growth in average interest-earning assets, which collectively increased 17% during 2005. Partially offsetting the growth in interest-earning assets was further contraction in the net interest margin, which declined 15 basis points from 2004. The decrease in the net interest margin was due to an increase in the cost of the Company s interest-bearing liabilities, which was driven by continual increases in short-term interest rates since June of 2004. This causes compression in the margin as the Company s interest-bearing liabilities reprice at a faster pace than the Company s interest-earning assets. Partially mitigating the disparity in repricing speeds during 2005 was growth in home equity lines of credit balances, which have repricing frequencies that are more closely aligned with the faster repricing behavior of the Company s wholesale borrowings.

Interest rate contracts, including embedded derivatives, held for asset/liability risk management purposes increased net interest income by $52 million in 2005. Such interest rate contracts, including embedded derivatives, decreased net interest income by $222 million in 2004.

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

	Year Ended December 31,								
	2005			2004			2003		
	Average Balance	Rate	Interest Income	Average Balance	Rate	Interest Income	Average Balance	Rate	Interest Income
	(dollars in millions)								
Assets									
Interest-earning assets:									
Federal funds sold and securities purchased under agreements to resell	$ 2,154	3.42 %	$ 74	$ 884	1.42 %	$ 13	$ 2,570	1.45 %	$ 37
Trading assets	7,217	6.50	469	2,368	6.39	151	1,235	6.78	84
Available-for-sale securities(1):									
Mortgage-backed securities	16,347	4.80	784	10,255	3.99	409	20,977	4.91	1,030
Investment securities	4,506	4.74	214	10,732	3.30	355	18,742	3.77	708
Loans held for sale(2)	44,847	5.31	2,382	29,721	4.95	1,472	45,438	5.51	2,501
Loans held in portfolio(2)(3):									
Loans secured by real estate:									
Home(4)	110,326	4.90	5,403	107,518	4.21	4,529	86,443	4.77	4,124
Specialty mortgage finance(5)	20,555	5.19	1,066	15,767	4.84	763	10,794	5.43	586
Total home loans	130,881	4.94	6,469	123,285	4.29	5,292	97,237	4.84	4,710
Home equity loans and lines of credit	47,915	5.93	2,841	35,859	4.69	1,683	21,163	4.98	1,053
Home construction(6)	2,074	6.22	129	2,489	5.50	137	2,062	5.90	122
Multi-family	24,070	5.31	1,279	21,090	4.96	1,046	19,409	5.30	1,029
Other real estate	5,091	6.56	334	6,396	5.94	380	7,243	6.35	460
Total loans secured by real estate	210,031	5.26	11,052	189,119	4.51	8,538	147,114	5.01	7,374
Consumer:									
Credit card	2,082	11.96	249						
Other	707	10.66	75	899	10.11	91	1,208	8.87	107
Commercial business	2,614	5.00	131	4,415	4.43	196	4,165	4.49	187
Total loans held in portfolio	215,434	5.34	11,507	194,433	4.54	8,825	152,487	5.03	7,668
Other(7)	4,367	3.63	158	4,108	3.05	125	3,874	3.47	135
Total interest-earning assets	294,872	5.29	15,588	252,501	4.50	11,350	245,323	4.96	12,163
Noninterest-earning assets:									
Mortgage servicing rights	6,597			6,406			5,721		
Goodwill	6,712			6,196			6,198		
Other assets(8)	18,159			18,975			25,877		
Total assets	$326,340			$284,078			$283,119		

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

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

(3) Interest income for loans held in portfolio includes amortization of net deferred loan origination costs of $401 million, $351 million, and $314 million for the years ended December 31, 2005, 2004 and 2003.

(4) Deferred interest recognized in earnings that resulted from negative amortization within the Option ARM portfolio totaled $316 million, $19 million and $7 million for the years ended December 31, 2005, 2004 and 2003.

(5) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its investment portfolio.

(6) 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.

(7) Interest-earning assets in nonaccrual status (other than loans) and related income, if any, are included within

this category.

(8) Includes assets of continuing and discontinued operations.

(This table is continued on next page.)

	Year Ended December 31,								
	2005			2004			2003		
	Average Balance	Rate	Interest Expense	Average Balance	Rate	Interest Expense	Average Balance	Rate	Interest Expense
	(dollars in millions)								
Liabilities									
Interest-bearing liabilities:									
Deposits:									
Interest-bearing checking deposits	$46,524	1.95 %	$ 906	$59,826	1.28 %	$ 766	$62,723	1.69 %	$1,057
Savings and money market deposits	42,555	1.76	750	35,927	1.11	399	28,085	0.94	263
Time deposits	62,175	3.33	2,072	35,917	2.44	878	31,416	2.69	845
Total interest-bearing deposits	151,254	2.46	3,728	131,670	1.55	2,043	122,224	1.77	2,165
Federal funds purchased and commercial paper	5,314	3.56	190	3,522	1.50	53	3,158	1.18	37
Securities sold under agreements to repurchase	15,365	3.40	523	16,660	2.26	377	22,318	2.44	545
Advances from Federal Home Loan Banks	68,713	3.46	2,377	58,622	2.16	1,268	49,441	2.62	1,296
Other	21,603	4.09	884	13,724	3.59	493	13,315	3.68	491
Total interest-bearing liabilities	262,249	2.94	7,702	224,198	1.89	4,234	210,456	2.15	4,534
Noninterest-bearing sources:									
Noninterest-bearing deposits	34,769			33,738			41,361		
Other liabilities(9)	6,192			5,951			11,061		
Stockholders equity	23,130			20,191			20,241		
Total liabilities and stockholders equity	$326,340			$284,078			$283,119		
Net interest spread and net interest income		2.35	$7,886		2.61	$7,116		2.81	$7,629
Impact of noninterest-bearing sources		0.32			0.21			0.30	
Net interest margin		2.67			2.82			3.11	

(9) Includes liabilities of continuing and discontinued operations.

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 rate multiplied by the prior period s volume), and (iii) changes in rate/volume (changes in rate times the change in volume) which were allocated proportionately to the changes in volume and the changes in rate and included in the relevant column below were as follows:

	2005 vs. 2004 Increase/(Decrease) Due to Volume	Rate	Total Change	2004 vs. 2003 Increase/(Decrease) Due to Volume	Rate	Total Change
	(in millions)					
Interest Income						
Federal funds sold and securities purchased under agreements to resell	$ 31	$ 30	$ 61	$ (24)	$	$ (24)
Trading assets	315	3	318	73	(6)	67
Available-for-sale securities:						
Mortgage-backed securities	280	95	375	(454)	(167)	(621)
Investment securities	(257)	116	(141)	(273)	(80)	(353)
Loans held for sale	797	113	910	(798)	(231)	(1,029)
Loans held in portfolio:						
Loans secured by real estate:						
Home	121	754	875	926	(521)	405
Specialty mortgage finance(1)	245	57	302	246	(69)	177
Total home loans	366	811	1,177	1,172	(590)	582
Home equity loans and lines of credit	649	509	1,158	693	(63)	630
Home construction(2)	(24)	16	(8)	24	(9)	15
Multi-family	155	78	233	86	(69)	17
Other real estate	(83)	37	(46)	(52)	(28)	(80)
Total loans secured by real estate	1,063	1,451	2,514	1,923	(759)	1,164
Consumer:						
Credit card	249		249			
Other	(20)	4	(16)	(30)	14	(16)
Commercial business	(88)	23	(65)	11	(2)	9
Total loans held in portfolio	1,204	1,478	2,682	1,904	(747)	1,157
Other	8	25	33	7	(17)	(10)
Total interest income	2,378	1,860	4,238	435	(1,248)	(813)
Interest Expense						
Deposits:						
Interest-bearing checking deposits	(197)	336	139	(47)	(244)	(291)
Savings and money market deposits	84	268	352	82	54	136
Time deposits	797	397	1,194	114	(81)	33
Total deposits	684	1,001	1,685	149	(271)	(122)
Federal funds purchased and commercial paper	37	100	137	5	11	16
Securities sold under agreements to repurchase	(31)	177	146	(130)	(38)	(168)
Advances from Federal Home Loan Banks	247	862	1,109	218	(246)	(28)
Other	315	76	391	15	(13)	2
Total interest expense	1,252	2,216	3,468	257	(557)	(300)
Net interest income	$1,126	$(356)	$ 770	$ 178	$ (691)	$ (513)

(1) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its investment portfolio.

(2) 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.

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Noninterest Income

Noninterest income from continuing operations consisted of the following:

	Year Ended December 31,			Percentage Change	
	2005	2004	2003	2005/2004	2004/2003
	(in millions)				
Revenue from sales and servicing of home mortgage loans	$2,030	$1,387	$1,974	46 %	(30)%
Revenue from sales and servicing of consumer loans	413	4	3		38
Depositor and other retail banking fees	2,193	1,999	1,818	10	10
Credit card fees	139				
Securities fees and commissions	448	426	395	5	8
Insurance income	172	226	188	(24)	20
Portfolio loan related income	387	401	439	(3)	(9)
Trading assets income (loss)	(257)	89	116		(23)
Gain (loss) from other available-for-sale securities	(84)	50	676		(93)
Gain (loss) on extinguishment of borrowings	1	(237)	(129)		84
Other income	296	267	370	10	(28)
Total noninterest income	$5,738	$4,612	$5,850	24	(21)

Revenue from sales and servicing of home mortgage loans

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

	Year Ended December 31,			Percentage Change	
	2005	2004	2003	2005/2004	2004/2003
	(in millions)				
Revenue from sales and servicing of home mortgage loans:					
Sales activity:					
Gain from home mortgage loans and originated mortgage-backed securities	$ 850	$ 651	$ 1,570	31 %	(59)%
Revaluation gain (loss) from derivatives	99	80	(159)	23	
Gain from home mortgage loans and originated mortgage-backed securities, net of hedging and risk management instruments	949	731	1,411	30	(48)
Servicing activity:					
Home mortgage loan servicing revenue, net(1)	2,123	1,943	2,080	9	(7)
Amortization of MSR	(2,170)	(2,521)	(3,269)	(14)	(23)
MSR valuation adjustments(2)	965	(235)	712		
Revaluation gain from derivatives	163	1,469	1,040	(89)	41
Home mortgage loan servicing revenue, net of hedging and derivative risk management instruments	1,081	656	563	65	16
Total revenue from sales and servicing of home mortgage loans	2,030	1,387	1,974	46	(30)
Impact of other MSR risk management instruments:					
Revaluation gain (loss) from certain trading securities	(223)	81			
Gain (loss) from certain available-for-sale securities	(18)	1	305		(100)
Total impact of other MSR risk management instruments	(241)	82	305		(73)
Total revenue from sales and servicing of home mortgage loans and all MSR risk management instruments	$ 1,789	$ 1,469	$ 2,279	22	(36)

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(1) Includes late charges, prepayment fees and loan pool expenses (the shortfall of the scheduled interest required to be remitted to investors compared to what is collected from the borrowers upon payoff).

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

Revenue from sales and servicing of home mortgage loans, including the effects of all MSR risk management instruments, increased $320 million, or 22%, from 2004. Gain from home mortgage loans and mortgage-backed securities, net of hedging and risk management instruments increased $218 million, or 30%, as the strength of the U.S. housing market fueled strong customer demand for fixed-rate mortgages and the Company s option adjustable-rate mortgage product (Option ARM). In particular, the sustained liquidity of the Option ARM product in the secondary market enabled the Company to sell approximately $48.13 billion of Option ARM loans during 2005, compared with $14.12 billion in 2004. The Company also sells substantially all of its fixed-rate and medium-term adjustable-rate home loan volume.

The fair value changes in loans held for sale and the offsetting changes in the derivative instruments used as fair value hedges are recorded within gain from mortgage loans when hedge accounting treatment is achieved. 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 in earnings, 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. At December 31, 2005, the amount by which the aggregate fair value of loans held for sale exceeded their aggregate cost basis was approximately $117 million.

The following table presents the aggregate valuation adjustments for the MSR and the corresponding hedging and risk management derivative instruments and securities, and amortization of the MSR during the years ended December 31, 2005, 2004 and 2003:

	Year Ended December 31,		
	2005	2004	2003
	(in millions)		
MSR Risk Management and Amortization:			
MSR valuation adjustments:			
Statement No. 133 MSR accounting valuation adjustments	$ 999	$ 699	$
Amortization of MSR	(2,170)	(2,521)	(3,269)
(Impairment) reversal	943	(466)	712
Net change in MSR valuation	(228)	(2,288)	(2,557)
Gain (loss) on MSR hedging and risk management instruments:			
Statement No. 133 fair value hedging adjustments	(977)	(468)	
Revaluation gain from derivatives	163	1,469	1,040
Revaluation gain (loss) from certain trading securities	(223)	81	
Gain (loss) from certain available-for-sale securities	(18)	1	305
Total gain (loss) on MSR hedging and risk management instruments	(1,055)	1,083	1,345
Total MSR risk management and amortization	$ (1,283)	$ (1,205)	$ (1,212)

The following tables reconcile the gains (losses) on investment securities that are designated as MSR risk management instruments to trading assets income (loss) and the gain (loss) on other available-for-sale securities that are reported within noninterest income during the years ended December 31, 2005, 2004 and 2003:

	Year Ended December 31, 2005		
	MSR	Other	Total
	(in millions)		
Trading assets loss	$ (223)	$ (34)	$ (257)
Loss from other available-for-sale securities	(18)	(66)	(84)

	Year Ended December 31, 2004		
	MSR	Other	Total
	(in millions)		
Trading assets income	$ 81	$ 8	$ 89
Gain from other available-for-sale securities	1	49	50

	Year Ended December 31, 2003		
	MSR	Other	Total
	(in millions)		
Trading assets income	$	$ 116	$ 116
Gain from other available-for-sale securities	305	371	676

Total MSR risk management and amortization was $(1.28) billion in 2005, compared with $(1.21) billion in 2004. Although average mortgage rates on conventional fixed-rate loans for 2005 were only slightly higher than at the end of 2004, more significant fluctuations occurred over the course of 2005. The Federal National Mortgage Association (FNMA) 30-year fixed mortgage rate, for example, reached a 2005 high of 5.96% in November and a low of 4.93% in June. As interest rates fluctuate, spreads between mortgage rate indices and the indices of interest rate derivative contracts that are used for MSR risk management purposes may expand or compress, which causes the change in value of the risk management instruments to differ from changes in value of the MSR. The benchmark 10-year interest rate swap, for example, reached a high of 5.21% in November of 2005 and a low of 4.30% in June of 2005. To mitigate the earnings volatility that occurs when spreads between interest rate indices fluctuate, the Company restructured the composition of its MSR risk management portfolio in the latter half of 2004. The portfolio now encompasses a broader array of instruments, such as principal-only mortgage-backed securities and forward commitments to purchase and sell mortgage-backed securities, whose valuation adjustments are determined by changes in mortgage interest rates.

Since the second quarter of 2004, the Company has applied fair value hedge accounting treatment, as prescribed by Statement No. 133, as amended, to most of its MSR. The application of this guidance results in netting of the changes in fair value of the hedged MSR with the changes in fair value of the hedging derivative in the Consolidated Statements of Income, if the hedge relationship is determined to be highly effective. The Company uses conventional statistical methods of correlation to determine if the results of the changes in value of the hedged MSR and the hedging derivative meet the Statement No. 133, as amended, criteria for a highly effective hedge accounting relationship. Under lower of cost or fair value accounting, impairment is recognized through a valuation allowance. The portion of the MSR in which the hedging relationship is determined not to be highly effective will continue to be accounted for at the lower of cost or fair value.

The FASB has released an exposure draft, which would amend Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and specifically addresses accounting for servicing of financial assets. For each class of separately recognized servicing assets, this proposed Statement would permit an entity to choose either to continue the current practice of amortizing servicing assets in proportion to and over the period of estimated net servicing income and assess servicing assets for impairment at each reporting date, or to report servicing assets at fair value at each reporting

date and report changes in fair value in earnings in the period in which the changes occur. This proposed Statement also would require additional disclosures for all separately recognized servicing assets. If the Company were to elect the fair value option of this proposed Statement, the separate calculations and disclosures of amortization and impairment would discontinue and be replaced with a fair value adjustment that encompasses both market-driven valuation changes and the runoff in value that occurs from the passage of time. The Company is assessing the potential impact of this guidance. The FASB plans to issue this Statement in the first quarter of 2006.

During 2005, the Company recorded an other-than-temporary MSR impairment of $106 million on the MSR asset. This amount was determined by applying an appropriate interest rate shock to the MSR in order to estimate the amount of the valuation allowance that is expected to be recovered in the foreseeable future. To the extent that the gross carrying value of the MSR, including the Statement No. 133, as amended, valuation adjustments, exceeded the estimated recoverable amount, that portion of the gross carrying value was written off as other-than-temporary impairment. Although the writedowns had no impact on the Company s results of operations or financial condition, they did reduce the gross carrying value of the MSR, which is used as the basis for MSR amortization. The Company recorded other-than-temporary MSR impairment of $895 million in 2004.

In evaluating the MSR for impairment, loans are stratified in the servicing portfolio based on loan type and coupon rate. An impairment valuation allowance for a stratum is recorded when, and in the amount by which, its fair value is less than its gross carrying value. A reversal of the impairment allowance for a stratum is recorded when its fair value exceeds its net carrying value. However, a reversal in any particular stratum cannot exceed its valuation allowance. At December 31, 2005, loans in the servicing portfolio were stratified as follows:

		December 31, 2005			
	Rate Band	**Gross Carrying Value (in millions)**	**Valuation Allowance**	**Net Carrying Value**	**Fair Value**
Primary Servicing:					
Adjustable	All loans	$ 1,572	$	$ 1,572	$ 1,607
Government-sponsored enterprises	6.00% and below	3,622	(196)	3,426	3,426
Government-sponsored enterprises	6.01% to 7.49%	1,282	(365)	917	917
Government-sponsored enterprises	7.50% and above	108	(1)	107	107
Government	6.00% and below	546	(91)	455	455
Government	6.01% to 7.49%	381	(113)	268	268
Government	7.50% and above	126	(43)	83	83
Private	6.00% and below	597	(8)	589	589
Private	6.01% to 7.49%	295	(57)	238	238
Private	7.50% and above	61	(14)	47	47
Total primary servicing		8,590	(888)	7,702	7,737
Master servicing	All loans	96		96	114
Subprime	All loans	227	(26)	201	201
Multi-family	All loans	42		42	46
Total		$ 8,955	$ (914)	$ 8,041	$ 8,098

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 anticipated. Moreover, since most loans within the servicing portfolio do not contain penalty provisions for early payoff, a corresponding economic benefit will not be received if the loan pays off earlier than expected. MSR represent the discounted 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 impairment.

The Company estimates fair value of each MSR stratum using a discounted cash flow model. The discounted cash flow model calculates the present value of the estimated future net cash flows of the servicing portfolio based on various factors, such as servicing costs, expected prepayment speeds and discount rates, about which management must make assumptions based on future expectations. While the Company s model estimates a value, the specific value used is based on a variety of market-based factors, such as documented observable data and anticipated changes in prepayment speeds. The reasonableness of management s assumptions about these factors is evaluated through quarterly independent broker surveys. Independent appraisals of the fair value of the servicing portfolio are obtained periodically, but not less frequently than quarterly, and are used by management to evaluate the reasonableness of the fair value conclusions.

The fair value of MSR is highly sensitive to changes in assumptions. For example, the determination of fair value uses anticipated prepayment speeds. Actual prepayment experience may differ and any difference may have a material effect on MSR fair value. Changes in fair value resulting from changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Thus, any measurement of MSR fair value is limited by the conditions existing and assumptions made as of a particular point in time. Those assumptions may not be appropriate if they are applied to a different point in time. Refer to Market Risk Management for discussion of how MSR prepayment risk is managed and to Note 1 to the Consolidated Financial Statements Summary of Significant Accounting Policies for further discussion of how MSR impairment is measured. For a quantitative analysis of key economic assumptions used in measuring the fair value of MSR, and a sensitivity analysis based on changes to those assumptions, see Note 7 to the Consolidated Financial Statements Mortgage Banking Activities.

All Other Noninterest Income

The addition of the Card Services Group on October 1, 2005 added more than $400 million of revenue from sales and servicing of consumer loans and $139 million of credit card fee income.

Depositor and other retail banking fees increased by $194 million, or 10%, primarily due to higher levels of checking fees that resulted from an increase in the number of noninterest-bearing checking accounts and an increase in debit card interchange and ATM-related income. The number of noninterest-bearing checking accounts at December 31, 2005 totaled approximately 7.8 million, compared with approximately 7.1 million at December 31, 2004.

Insurance income decreased $54 million, or 24%, primarily due to a decline in mortgage-related insurance income, as payoffs of loans with mortgage insurance more than offset insurance income generated from loan volume during 2005.

Several securities sold under agreements to repurchase (repurchase agreements) with embedded pay-fixed swaps were terminated during the third quarter of 2004, resulting in a net loss on extinguishment of borrowings of $147 million. During the first half of 2004, the Company terminated certain pay-fixed swaps hedging variable rate FHLB advances, resulting in a loss of $90 million. These transactions had the immediate effect of reducing the Company s wholesale borrowing costs.

Noninterest Expense

Noninterest expense from continuing operations consisted of the following:

	Year Ended December 31,			Percentage Change	
	2005	2004	2003	2005/2004	2004/2003
	(in millions)				
Compensation and benefits	$ 3,737	$ 3,428	$ 3,304	9 %	4 %
Occupancy and equipment	1,523	1,659	1,592	(8)	4
Telecommunications and outsourced information services	450	479	554	(6)	(14)
Depositor and other retail banking losses	226	195	154	16	27
Advertising and promotion	327	276	278	19	(1)
Professional fees	182	158	267	15	(41)
Postage	293	232	220	26	6
Loan expense	101	111	125	(9)	(11)
Other expense	1,031	997	914	3	9
Total noninterest expense	$ 7,870	$ 7,535	$ 7,408	4	2

Employee compensation and benefits increased $309 million, or 9%, from 2004 primarily due to higher salaries expense resulting from an increase in employees, due to growth in the Company s operations. The Company also incurred a $45 million increase in salaries expense due to the addition of Card Services. The number of employees was 60,798 at December 31, 2005 compared with 52,579 at December 31, 2004.

The decrease in occupancy and equipment expense during 2005 was primarily due to decreased depreciation and lease expense and a decline in losses recognized on the disposal of assets.

The increase in depositor and other retail banking losses during 2005 was largely due to higher levels of overdraft charge-offs, losses from returned deposited checks and debit card and check fraud.

The increase in advertising and promotion expense in 2005 was primarily due to marketing and other professional services expense incurred due to the addition of the Card Services Group in the fourth quarter.

Professional fees increased in 2005 primarily due to both increased outside attorney fees for litigation related to supervisory goodwill lawsuits, in which the Company is a plaintiff, and increased outside recruiting fees.

Postage expense increased during 2005 largely due to increased direct mail volume related to the Card Services Group.

<u>Review of Financial Condition</u>

Available-for-Sale Securities

Securities consisted of the following:

	December 31,	
	2005	2004
	(in millions)	
Available-for-sale securities, total amortized cost of $24,810 and $19,047:		
Mortgage-backed securities	$ 20,648	$ 14,923
Investment securities	4,011	4,296
Total available-for-sale securities	$ 24,659	$ 19,219

The Company holds available-for-sale securities primarily for interest rate risk management and liquidity enhancement purposes. The Company s available-for-sale securities increased $5.44 billion during 2005 predominantly due to the purchase of mortgage-backed securities. Refer to Note 4 to the Consolidated Financial Statements Securities for additional information on securities, classified by security type.

Loans

Total loans consisted of the following:

	December 31, 2005 (in millions)	2004	2003	2002	2001
Loans held for sale	$ 33,582	$ 42,743	$ 20,837	$ 39,623	$ 27,574
Loans held in portfolio:					
Loans secured by real estate:					
Home loans(1)	135,290	129,134	113,016	92,970	87,833
Home equity loans and lines of credit	50,851	43,650	27,647	16,168	7,970
Home construction(2)	2,037	2,344	2,220	1,949	2,602
Multi-family(3)	25,601	22,282	20,324	18,000	15,608
Other real estate(4)	5,035	5,664	6,649	7,986	6,089
Total loans secured by real estate	218,814	203,074	169,856	137,073	120,102
Consumer:					
Credit card	8,043				
Other	638	792	1,028	1,663	2,009
Commercial business	2,137	3,205	4,266	4,292	4,285
Total loans held in portfolio(5)	$ 229,632	$ 207,071	$ 175,150	$ 143,028	$ 126,396

(1) Includes specialty mortgage finance loans, which are comprised of purchased subprime home loans and subprime home loans originated by Long Beach Mortgage Company and held in its investment portfolio. Specialty mortgage finance loans were $21.15 billion, $19.18 billion, $12.98 billion, $10.13 billion and $8.21 billion at December 31, 2005, 2004, 2003, 2002 and 2001.

(2) 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.

(3) Includes multi-family construction balances of $632 million in 2005, $333 million in 2004, $325 million in 2003, $491 million in 2002 and $385 million in 2001.

(4) Includes other commercial real estate construction balances of $208 million in 2005, $277 million in 2004, $382 million in 2003, $469 million in 2002 and $608 million in 2001.

(5) Includes net unamortized deferred loan origination costs of $1.53 billion, $1.25 billion, $1.01 billion, $587 million and $433 million at December 31, 2005, 2004, 2003, 2002 and 2001.

Total home loans consisted of the following:

	December 31, 2005 (in millions)	2004
Home loans:		
Short-term adjustable-rate loans(1):		
Option ARMs(2)	$ 70,191	$ 66,310
Other ARMs	14,666	9,065
Total short-term adjustable-rate loans	84,857	75,375
Medium-term adjustable-rate loans(3)	41,511	45,197
Fixed-rate loans	8,922	8,562
Total home loans	$ 135,290	$ 129,134

(1) Short-term is defined as adjustable-rate loans that reprice within one year or less.

(2) The total amount by which the unpaid principal balance (UPB) of Option ARM loans exceeded their original principal amount was $157 million and $11 million at December 31, 2005 and 2004.

(3) Medium-term is defined as adjustable-rate loans that reprice after one year.

During most of 2005, loans held for sale remained at elevated levels, with an average balance during 2005 of $44.85 billion compared with $29.72 billion during 2004. As the yield curve continued to flatten during 2005, it began to influence the product mix of loans originated, steering customers towards fixed-rate products, which the Company generally designates for sale. Additionally, during 2005 the

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Company designated approximately $43.97 billion of Option ARMs for sale, representing 70% of 2005 Option ARM volume, compared with $31.48 billion, or 47% of Option ARM volume in 2004.

The Company s loans held in portfolio increased $22.56 billion to $229.63 billion at December 31, 2005 from $207.07 billion at December 31, 2004. The increase was substantially due to the addition of the credit card portfolio from the Card Services Group and an increase in total home loan and home equity loans and lines of credit balances. Primarily all of the growth in the home loan and home equity loan and line of credit portfolios resulted from the origination of short-term adjustable-rate products. The Company s short-term adjustable-rate home loans, which were predominantly comprised of Option ARM loans, increased from $75.38 billion at December 31, 2004 to $84.86 billion at December 31, 2005.

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

	December 31, 2005			
	Due Within One Year	**After One But Within Five Years**	**After Five Years**	**Total**
	(in millions)			
Home construction:				
Adjustable rate	$ 829	$ 88	$ 1	$ 918
Fixed rate	203	4	912	1,119
Multi-family construction:				
Adjustable rate	251	220	2	473
Fixed rate	47	59	53	159
Other commercial real estate construction:				
Adjustable rate	58	143	1	202
Fixed rate	4	2		6
Commercial business:				
Adjustable rate	1,586	166	94	1,846
Fixed rate	28	205	58	291
Total	$ 3,006	$ 887	$ 1,121	$ 5,014

Deposits

Deposits consisted of the following:

	December 31, 2005	**2004**
	(in millions)	
Retail deposits:		
Checking deposits:		
Noninterest bearing	$ 20,752	$ 17,463
Interest bearing	42,253	51,099
Total checking deposits	63,005	68,562
Savings and money market deposits	36,664	36,836
Time deposits	40,359	27,268
Total retail deposits	140,028	132,666
Commercial business deposits	11,459	7,611
Wholesale deposits	29,917	18,448
Custodial and escrow deposits(1)	11,763	14,933
Total deposits	$ 193,167	$ 173,658

(1) Substantially all custodial and escrow deposits reside in noninterest-bearing checking accounts.

The increase in noninterest-bearing retail checking deposits was driven by an increase in the number of individual and small business checking accounts. Interest-bearing checking deposits decreased as customers shifted from Platinum checking accounts to time deposits as a result of higher rates offered for these products. Wholesale deposits increased 62% from 2004, due predominantly to an increase in institutional investor certificates of deposit as well as brokered certificates of deposit acquired from Providian Financial Corporation.

Transaction accounts (checking, savings and money market deposits) comprised 71% of retail deposits at December 31, 2005, compared with 79% at year-end 2004. 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. Deposits funded 56% of total assets at December 31, 2005 and 2004.

Operating Segments

The Company has four operating segments for the purpose of management reporting: the Retail Banking and Financial Services Group, the Home Loans Group (previously called the Mortgage Banking Group), the Card Services Group and the Commercial Group. The Retail Banking and Financial Services Group, the Home Loans Group and the Card Services 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 as well as the Treasury function which manages the Company s interest rate risk, liquidity, capital, borrowings, and a majority of the Company s investment securities. The Corporate Support function provides facilities, legal, accounting and finance, human resources and technology services.

During the fourth quarter of 2005, the Company announced its plans to reorganize its single family residential mortgage lending operations. This reorganization combined the Company s subprime mortgage origination business, Long Beach Mortgage Company, as well as its Mortgage Banker Finance lending operations within the Home Loans Group. This change in structure was effective as of January 1, 2006. The following discussion and presentation of financial results reflects the structure that was in place during 2005.

The Company serves the needs of 19.5 million consumer households through its 2,140 retail banking stores, 487 lending stores and centers, 3,747 ATMs, telephone call centers and online banking.

The principal activities of the **Retail Banking and Financial Services Group** include:

- Offering a comprehensive line of deposit and other retail banking products and services to consumers and small businesses;

- Originating, managing and servicing home equity loans and lines of credit;

- Providing investment advisory and brokerage services, sales of annuities, mutual fund management and other financial services; and

- Holding the Company s portfolio of home loans held for investment, excluding loans originated by Long Beach Mortgage Company (which are held by the Commercial Group).

Deposit products offered by the segment in all its stores 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.

Financial consultants provide investment advisory and securities brokerage services to the public while licensed bank employees offer fixed annuities. The Company s mutual fund management business offers investment advisory and mutual fund distribution services.

This segment s home loan portfolio consists of home loans purchased from both the Home Loans Group and secondary market participants. The segment also purchases and re-underwrites loans to subprime borrowers which are held in the home loan portfolio. Loans held in portfolio generate interest income and loan-related noninterest income, such as late fees and prepayment fees.

The principal activities of the **Home Loans Group** include:

- Originating and servicing home loans;
- Buying and selling home loans in the secondary market; and
- Selling insurance-related products and participating in reinsurance activities with other insurance companies.

Home loans are either originated in the retail and wholesale channels or are purchased from other lenders through the correspondent channel. The profitability of each channel varies over time and the Company s emphasis on each channel varies accordingly. The segment offers a wide variety of home loans, including:

- Fixed-rate home loans;
- Adjustable-rate home loans or ARMs (where the interest rate may be adjusted as frequently as every month);
- Hybrid home loans (where the interest rate is fixed for a predetermined time period, typically 3 to 5 years, and then converts to an ARM that reprices monthly or annually, depending on the product);
- Option ARM loans (for more details on Option ARMs, refer to Management s Discussion and Analysis Credit Risk Management); and
- Government insured or guaranteed home loans.

From an enterprise-wide perspective, loans are either retained or sold. Loans which are sold generate gain or loss on sale as well as interest income from the time they are funded until the time they are sold, while loans held in portfolio generate interest income and ancillary noninterest income. Fixed-rate home loans, which subject the Company to more interest rate risk than other types of home loans, are generally sold as part of the Company s overall asset/liability risk management process. The decision to retain or sell other home loan products requires balancing the combination of additional interest income and the interest rate and credit risks inherent with holding loans in portfolio, with the size of the gain or loss that would be realized if the loans were sold. Such decisions are elements of the Company s capital management process.

For management reporting purposes, home loans originated by this segment are either transferred through inter-segment sales to the Retail Banking and Financial Services Group or are sold to secondary market participants, including the housing government-sponsored enterprises such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) and the regional branches of the Federal Home Loan Banks. The premium received on inter-segment sales to the Retail Banking and Financial Services Group is based on prices available in the secondary market, adjusted for hedging costs.

The Home Loans Group typically retains the right to service all home loans, whether held for sale, sold to secondary market participants or held in portfolio by the Retail Banking and Financial Services Group. Mortgage servicing involves the administration and collection of home loan payments. In servicing home loans, the Company collects and remits loan payments, responds to borrower inquiries, applies the collected principal and interest to the individual loans, collects, holds and disburses escrow funds for payment of property taxes and insurance premiums, counsels delinquent customers, supervises

foreclosures and property dispositions and generally administers the loans. In return for performing these functions, the Company receives servicing fees and other remuneration.

In addition to selling loans to secondary market participants, the Home Loans Group generates both interest income and noninterest income by acquiring home loans from a variety of sources, pooling and securitizing those loans, selling the resulting mortgage-backed securities to secondary market participants and providing ongoing servicing and bond administration for all securities issued.

The Home Loans Group makes insurance products available to its customers that complement the mortgage process, including private mortgage insurance, mortgage life insurance, flood, homeowners , earthquake and other property and casualty insurance. Other types of insurance products made available include accidental death and dismemberment and term and whole life insurance. This segment also manages the Company s captive reinsurance activities.

The principal activities of the **Card Services Group** include:

- Originating and servicing of credit card loans; and
- Providing other cardholder services.

The Card Services Group manages the Company s credit card operations, which target customers by leveraging the Company s retail banking distribution network and through direct mail solicitations, which serve as the Group s primary new customer acquisition channels, augmented by online and telemarketing activities and other marketing programs. In addition to credit cards, this segment markets a variety of cardholder service products to its customer base. These products, which may be originated within the Company or jointly marketed with others, include debt suspension, auto- and health-related services, credit-related services, and selected insurance products.

The principal activities of the **Commercial Group** include:

- Providing financing to developers and investors for the acquisition or construction of multi-family dwellings and, to a lesser extent, other commercial properties;
- Originating and servicing multi-family and other commercial real estate loans and either holding such loans in portfolio as part of its commercial asset management business or selling them in the secondary market;
- Providing financing and other banking services to mortgage bankers for the origination of residential mortgage loans; and
- Originating and servicing home loans made to subprime borrowers through the Company s subsidiary, Long Beach Mortgage Company.

The multi-family lending business, which accounts for a majority of the Group s revenues, is comprised of three key activities: originating and managing loans retained in the loan portfolio, servicing all originated loans, whether they are retained or sold, and providing ancillary banking services to enhance customer retention. Combining these three activities into one integrated business model has allowed the Commercial Group to become a leading originator and holder of multi-family loans. The Group s multi-family lending program has a market share of more than 20% in certain key cities along the west coast, is rapidly gaining market share in certain key cities on the east coast and is targeting similar success in other selected target markets.

As part of the Company s specialty mortgage finance operations, the Group also originates home loans to subprime borrowers through the broker network maintained by Long Beach Mortgage Company, a wholly-owned subsidiary of the Company. Such loans may be held in the Company s specialty mortgage

finance home loan portfolio or sold to secondary market participants. The Company generally retains the servicing relationship on loans which it has sold.

The **Corporate Support/Treasury and Other** category includes enterprise-wide management of the Company s interest rate risk, liquidity, capital, borrowings, and a majority of the Company s investment securities. As part of the Company s asset and liability management process, the Treasury function provides oversight and direction across the enterprise over matters that impact the profile of the Company s balance sheet, such as product composition of loans that the Company holds in the 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. This category also includes the costs of the Company s technology services, facilities, legal, human resources, and accounting and finance functions to the extent not allocated to the business segments and the community lending and investment operations. Community lending and investment programs help fund the development of affordable housing units in traditionally underserved communities. Also reported in this category is the net impact of funds transfer pricing for loan and deposit balances, lower of cost or fair value adjustments and the write-off of inter-segment premiums associated with transfers of loans from the Retail Banking and Financial Services Group to the Home Loans Group when home loans previously designated as held for investment are moved to held for sale and all charges incurred from the Company s cost containment initiative, which was a key initiative during 2004.

Management Accounting Methodologies

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. In order to more closely align the segments operating results with other internal profitability measures, the Company has discontinued the practice of allocating a goodwill cost of capital charge to the operating segments. Prior periods have been conformed to reflect this change in methodology.

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 it is centrally managed. Certain basis and other residual risk remains in the operating segments;

- A calculation of the provision for loan and lease losses based on management s current assessment of the long-term, normalized net charge-off ratio for loan products within each segment, which is recalibrated periodically to the latest available loan loss experience data. This process differs from the losses inherent in the loan portfolio methodology that is used to measure the allowance for loan and lease losses for consolidated reporting purposes. This methodology is used to provide segment management with provision information for strategic decision making;

- 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; and

- Inter-segment activities which include the transfer of originated mortgage loans that are to be held in portfolio from the Home Loans Group to the Retail Banking and Financial Services Group and a broker fee arrangement between Home Loans and Retail Banking and Financial Services. When

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originated mortgage loans are transferred, the Home Loans Group records a gain on the sale of the loans based on an assumed profit factor. This profit factor is included as a premium to the value of the transferred loans, which is amortized as an adjustment to the net interest income recorded by the Retail Banking and Financial Services Group while the loan is held for investment. If a loan that was designated as held for investment is subsequently transferred to held for sale, the inter-segment premium is written off through Corporate Support/Treasury and Other. Inter-segment broker fees are recorded by the Retail Banking and Financial Services Group when home loans are initiated through retail banking stores, while the Home Loans Group records a broker fee when the origination of home equity loans and lines of credit are initiated through home loan stores. 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.

During the fourth quarter of 2005 the Company began integrating the Card Services Group into its management accounting process. During this period only the funds transfer pricing methodology was applied to this segment.

Financial highlights by operating segment were as follows:

Retail Banking and Financial Services Group

	Year Ended December 31,			Percentage Change	
	2005	2004	2003	2005/2004	2004/2003
	(dollars in millions)				
Condensed income statement:					
Net interest income	$ 5,478	$ 4,999	$ 3,851	10 %	30 %
Provision for loan and lease losses	165	164	175	1	(7)
Noninterest income	3,049	2,758	2,500	11	10
Inter-segment revenue	42	23	179	84	(87)
Noninterest expense	4,444	4,123	3,576	8	15
Income before income taxes	3,960	3,493	2,779	13	26
Income taxes	1,495	1,305	1,065	15	22
Net income	$ 2,465	$ 2,188	$ 1,714	13	28
Performance and other data:					
Efficiency ratio(1)	51.85 %	53.00 %	54.76 %	(2)	(3)
Average loans	$ 180,556	$ 163,328	$ 120,705	11	35
Average assets	193,342	175,713	132,411	10	33
Average deposits	136,894	130,337	125,440	5	4
Loan volume	46,951	55,282	29,717	(15)	86
Employees at end of period	30,437	27,341	26,564	11	3

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

The increases in net interest income were primarily due to higher average balances of home equity loans and lines of credit, largely offset by higher funding costs resulting from increasing short-term interest rates. The average balance of home equity loans and lines of credit was $47.91 billion in 2005, compared with $35.85 billion in 2004.

The increases in noninterest income were primarily due to growth in depositor and other retail banking fees that resulted from growth in the number of retail checking accounts and higher debit card interchange fees. Also contributing to the increase in 2005 was a $32 million gain from the sale of five retail branches in Texas. The number of retail checking accounts at December 31, 2005 totaled approximately 9.9 million, compared to 9.0 million in 2004.

The increases in noninterest expense were primarily due to higher compensation and benefits expense and occupancy and equipment expense. These increases are attributable to the continued expansion of the retail banking distribution network, which included the opening of 210 new retail banking stores during 2005 and 250 new retail banking stores during 2004.

Home Loans Group

	Year Ended December 31,			Percentage Change	
	2005	2004	2003	2005/2004	2004/2003
	(dollars in millions)				
Condensed income statement:					
Net interest income	$ 1,181	$ 1,240	$ 2,382	(5)%	(48)%
Provision for loan and lease losses			14		(100)
Noninterest income	2,192	2,228	2,926	(2)	(24)
Inter-segment expense	42	23	179	84	(87)
Noninterest expense	2,140	2,411	2,915	(11)	(17)
Income before income taxes	1,191	1,034	2,200	15	(53)
Income taxes	449	386	839	17	(54)
Net income	$ 742	$ 648	$ 1,361	15	(52)
Performance and other data:					
Efficiency ratio(1)	64.23 %	69.99 %	56.83 %	(8)	23
Average loans	$ 30,898	$ 23,591	$ 42,990	31	(45)
Average assets	52,915	41,934	70,305	26	(40)
Average deposits	14,036	16,299	27,112	(14)	(40)
Loan volume	172,928	182,212	374,004	(5)	(51)
Employees at end of period	13,256	13,838	22,287	(4)	(38)

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

The decrease in net interest income during 2005 was predominantly due to higher funding costs driven by increasing short-term interest rates, significantly offset by higher average balances of loans held for sale. The decrease during 2004 was largely driven by a decline in the average balances of loans held for sale and a decline in noninterest-bearing custodial and escrow deposits. This occurred due to a reduction in fixed-rate loan refinancing activity, compared with 2003 when interest rates were at record low levels. The average balance of loans held for sale totaled $30.80 billion in 2005, compared with $23.29 billion in 2004 and $41.21 billion in 2003. Loan volume in 2005 was $172.93 billion, compared with $182.21 billion in 2004.

The decrease in noninterest income during 2005 was primarily due to the increased cost of MSR risk management, reflecting the continued rise in interest rates and the flattening of the yield curve. This increase in the cost was partially offset by an increase in the gain on sale of mortgage loans, driven by an increase in sales volume.

The decreases in noninterest expense during 2005 and 2004 were primarily due to lower technology, occupancy and equipment and base compensation and benefits-related expenses. These decreases resulted from productivity improvements consisting of the conversion to a single loan platform during the second half of 2004, the consolidation of various locations and functions, and lower headcount, which decreased to 13,256 at December 31, 2005 from 13,838 at December 31, 2004.

Card Services Group

	October 1, 2005 (Acquisition Date) through December 31, 2005(1) (dollars in millions)
Condensed income statement:	
Net interest income	$ 637
Provision for loan and lease losses	454
Noninterest income	352
Noninterest expense	268
Income before income taxes	267
Income taxes	101
Net income	$ 166
Performance and other data:	
Efficiency ratio(2)	27.08 %
Average loans(3)	$ 4,908
Average assets(3)	5,595
Employees at end of period	3,124

(1) Securitization adjustments to arrive at the reported GAAP results for the fourth quarter of 2005 were: a decrease of $409 million in net interest income; an increase of $150 million in noninterest income; a decrease of $259 million in the provision for credit losses; a decrease of $11.01 billion in average loans; and a decrease of $9.27 billion in average assets.

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

(3) Presented on an annualized basis.

On October 1, 2005, the Company completed its acquisition of Providian Financial Corporation. As such, the financial results for 2005 only include the operating results for the final three months of that year. Operating results for the Card Services Group are presented on a managed basis as the Company treats securitized and sold credit card receivables as if they were still on the balance sheet in evaluating the overall performance of this operating segment. A managed basis presentation excludes the impact of securitizations, including their effect on income, the provision for credit losses and average loans and assets.

Commercial Group

	Year Ended December 31,			Percentage Change	
	2005	2004	2003	2005/2004	2004/2003
	(dollars in millions)				
Condensed income statement:					
Net interest income	$ 1,371	$ 1,314	$ 1,307	4 %	1 %
Provision for loan and lease losses	7	41	99	(83)	(59)
Noninterest income	478	379	528	26	(28)
Noninterest expense	637	594	511	7	16
Income from continuing operations before income taxes	1,205	1,058	1,225	14	(14)
Income taxes	455	395	468	15	(15)
Income from continuing operations	750	663	757	13	(13)
Income from discontinued operations, net of taxes			87		(100)
Net income	$ 750	$ 663	$ 844	13	(21)
Performance and other data:					
Efficiency ratio(1)	34.46 %	35.06 %	27.82 %	(2)	26
Average loans	$ 47,147	$ 37,916	$ 34,731	24	9
Average assets	51,594	42,474	42,853	21	(1)
Average deposits	7,872	7,108	5,384	11	32
Loan volume	41,000	28,978	28,356	41	2
Employees at end of period(2)	4,182	3,385	5,824	24	(42)

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

(2) Includes 2,346 employees reported as part of discontinued operations at December 31, 2003.

The increase in net interest income during 2005 was primarily due to higher average balances of loans held for sale, partially offset by higher funding costs due to rising short-term interest rates. The average balance of loans held for sale was $13.81 billion in 2005, compared with $6.28 billion in 2004.

The increase in noninterest income during 2005 was primarily due to increased trading securities income related to residual interests retained from securitizations conducted by Long Beach Mortgage Company and a $55 million gain from the sale of commercial mortgage-backed securities occurring in the fourth quarter of 2005. These increases in noninterest income were partially offset by lower gain from mortgage loans, net of risk management activities, which was affected by an increase in the Company s estimated liability to repurchase loans from previous whole loan sales that contained early payment default provisions. An early payment default occurs when the borrower fails to make the first post-sale payment due on the loan by a contractually specified date. Usually when such an event occurs, the fair value of the loan at the time of its repurchase is lower than the face value. In the fourth quarter of 2005, the Company experienced increased incidents of repurchases of early payment default loans sold by Long Beach Mortgage Company and this trend is expected to continue in the first part of 2006.

The increase in noninterest expense during 2005 was primarily due to higher compensation and benefits expense resulting from the growth in loan volume from Long Beach Mortgage Company. Long Beach Mortgage Company added 800 employees during 2005 to support its growing operations.

Corporate Support/Treasury and Other

	Year Ended December 31,			Percentage Change	
	2005	2004	2003	2005/2004	2004/2003
	(dollars in millions)				
Condensed income statement:					
Net interest income (expense)	$ (831)	$ (869)	$ (267)	(4)%	225 %
Provision for loan and lease losses	1	4	8	(81)	(51)
Noninterest income (expense)	(118)	(145)	648	(19)	
Noninterest expense	381	407	406	(6)	
Loss from continuing operations before income taxes	(1,331)	(1,425)	(33)	(7)	
Income tax benefit	(536)	(569)	(36)	(6)	
Income (loss) from continuing operations	(795)	(856)	3	(7)	
Income from discontinued operations, net of taxes		399		(100)	
Net income (loss)	$ (795)	$ (457)	$ 3	74	
Performance and other data:					
Average loans	$ 1,088	$ 889	$ 759	22	17
Average assets	26,982	25,753	39,371	5	(35)
Average deposits	27,221	11,664	5,649	133	106
Loan volume	278	261	168	7	55
Employees at end of period	9,799	8,015	9,045	22	(11)

Net interest expense during 2005 and 2004 reflects the impact of the funds transfer pricing process during a rising interest rate environment. As this process concentrates the interest rate sensitivities of assets and liabilities within the Treasury Division, the results were affected by the slower repricing frequencies of the Company s interest-earning assets.

The variance in noninterest income was primarily due to losses from the termination of repurchase agreements with embedded pay-fixed interest rate swaps in the third quarter of 2004.

The decrease in noninterest expense during 2005 was largely due to lower occupancy and equipment expense and telecommunications and outsourced information services expense, partially offset by an increase in employee base compensation and benefits expense.

Average loan balances are related to the Community Lending and Investment unit, which was transferred from the Commercial Group to Corporate Support/Treasury and Other during the third quarter of 2005.

The increases in average deposits were predominantly due to growth in institutional investor certificates of deposits as well as brokered certificates of deposits acquired through the merger of Providian Financial Corporation.

Income from discontinued operations resulted from the sale of the Company s subsidiary, Washington Mutual Finance Corporation, in the first quarter of 2004.

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 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 assets it can hold and the permitted sales, exchanges or distributions of its assets.

When the Company sells or securitizes loans, 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 may provide credit enhancement to the investors and, absent the violation of representations and warranties, generally represent the Company s maximum risk exposure associated with these transactions. Retained interests in mortgage loan securitizations, excluding the rights to service such loans, were $2.80 billion at December 31, 2005, of which $2.19 billion have either a AAA credit rating or are agency insured. Retained interests in credit card securitizations were $1.64 billion at December 31, 2005. Additional information concerning securitization transactions is included in Notes 6 and 7 to the Consolidated Financial Statements Securitizations and Mortgage Banking Activities.

Contractual Obligations

The following table presents, as of December 31, 2005, 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 include contracts related to services. The payment amounts represent those amounts contractually due to the recipient.

	Payments Due by Period (in millions)				
Contractual Obligations	**Total**	**Less than 1 year**	**1 but less than 3 years**	**3 but less than 5 years**	**5 years or more**
Debt obligations	$ 108,055	$ 51,439	$ 42,296	$ 3,134	$ 11,186
Capital lease obligations	91	16	31	17	27
Operating lease obligations	2,131	456	684	454	537
Purchase obligations(1)	793	221	326	134	112
Total contractual obligations	$ 111,070	$ 52,132	$ 43,337	$ 3,739	$ 11,862

(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 rates. Derivative contracts are carried at fair value on 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 daily as market interest rates change. Further discussion of derivative instruments is included in Notes 1 and 22 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 agreements 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 21 to the Consolidated Financial Statements Employee Benefits Programs and Other Expense.

Capital Adequacy

The regulatory capital ratios of Washington Mutual Bank and Washington Mutual Bank fsb (WMBfsb) and minimum regulatory capital ratios to be categorized as well-capitalized were as follows:

	December 31, 2005		Well-Capitalized
	WMB	WMBfsb	Minimum
Tier 1 capital to adjusted total assets (leverage)	6.47 %	85.21 %	5.00 %
Adjusted tier 1 capital to total risk-weighted assets	8.49	383.89	6.00 %
Total risk-based capital to total risk-weighted assets	11.50	383.91	10.00 %

	December 31, 2004		Well-Capitalized
	WMB	WMBfsb	Minimum
Tier 1 capital to adjusted total assets (leverage)	5.35 %	93.67 %	5.00 %
Adjusted tier 1 capital to total risk-weighted assets	7.96	393.52	6.00 %
Total risk-based capital to total risk-weighted assets	11.53	393.56	10.00 %

The Company s federal savings bank subsidiaries are also required by Office of Thrift Supervision regulations to maintain tangible capital of at least 1.50% of assets. WMB and WMBfsb satisfied this requirement at December 31, 2005 and December 31, 2004.

The Company s broker-dealer subsidiaries are also subject to capital requirements. At December 31, 2005 and 2004, all of its broker-dealer subsidiaries were in compliance with their applicable capital requirements.

On February 1, 2004, WMBfsb became a subsidiary of WMB. This reorganization was followed by the contribution of $23.27 billion of mortgage-backed and investment securities by WMB to WMBfsb on March 1, 2004. Due to the low risk weights assigned to these securities under the federal banking agency regulatory capital guidelines, their contribution to WMBfsb s capital base substantially increased that entity s risk-based capital ratios.

In 2003, the Company adopted a share repurchase program approved by the Board of Directors (the 2003 Program). Under the 2003 Program, the Company was authorized to repurchase up to 100 million shares of its common stock. On October 18, 2005, the Company discontinued the 2003 Program and adopted a new share repurchase program approved by the Board of Directors (the 2005 Program). The Company had repurchased 64.8 million shares under the 2003 Program prior to its discontinuance. Under the 2005 Program, the Company is authorized to repurchase up to 100 million shares of its common stock, as conditions warrant. There is no fixed termination date for the 2005 Program, and purchases may be made in the open market, through block trades, accelerated share repurchase transactions and other private transactions.

In October 2005, the Company entered into a contractual agreement with an investment bank under which the Company repurchased 15.5 million shares of its outstanding common stock at an initial purchase price of $38.26 per share, for a preliminary total of $593 million. Under the agreement, the counterparty borrowed the shares at the contract s inception, which were sold to, and immediately canceled by, the Company. In turn, the counterparty purchased the borrowed shares in the open market over a subsequent

time period. The agreement was subject to a future contingent purchase price adjustment based on the actual costs of the shares purchased by the counterparty, and the contract allowed for the settlement of this adjustment to occur either in cash or shares of Washington Mutual common stock, at the Company s option. On January 31, 2006, the contract was settled in cash, based on an average share price of $43.18. As this price exceeded the purchase price at the contract s inception, the Company paid an additional $76 million to the counterparty on the settlement date. This additional amount was recorded in the first quarter of 2006 as a reduction of capital surplus.

At February 28, 2006, the total remaining common stock repurchase authority under the 2005 Program was approximately 71.5 million shares.

As a result of recently revised guidance from the Company s ratings agencies that allows high equity content securities, such as preferred stock and hybrid capital instruments, to be included as core capital elements within the capital structures of financial institutions, the Company initiated a review of its capital funding and issuance strategies, and adopted a capital management program that is consistent with the revised guidance. As part of this program, the Company issued $2 billion of high equity content securities in March 2006 through Washington Mutual Preferred Funding LLC, an indirect subsidiary of Washington Mutual Bank. As core capital elements, such securities will be included as equity components within the Company s tangible equity to total tangible assets ratio.

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 assessment. The Company s Enterprise Risk Management function oversees the identification, measurement, monitoring, control and reporting of credit, market and operational risks. 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, provides independent assessment of the Company s compliance with risk management controls, policies and procedures.

The Audit Committee of the Board of Directors oversees the Company s monitoring and controlling of significant risk exposures, including the Company s guidelines and policies governing risk assessment and 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. Risk oversight is also provided by management committees whose membership includes representation from the Company s lines of business and the Enterprise Risk Management function. These committees include the Enterprise Risk Management Committee, the Credit Policy Committee, the Market Risk Committee and the Asset and Liability Committee.

Enterprise Risk Management works 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 and oversees compliance with laws and regulations.

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 ability to meet its financial obligations under agreed-upon terms and exists primarily in lending and derivative portfolios. The degree of credit risk will vary based on many factors including the size of the asset or transaction, the credit characteristics of the borrower, the contractual terms of the agreement and the availability and quality of collateral. For additional details on derivative counterparty credit risk see Management s Discussion and Analysis Derivative Counterparty Credit Risk .

The Finance Committee of the Board of Directors, by means of a broad set of policies and principles contained in the Company s Credit Policy, exercises oversight over the framework for the Company s credit risk management activities. The Credit Policy Committee, chaired by the Chief Credit Officer and comprised of senior management, evaluates and approves credit standards (including key features of residential loans) and is responsible for oversight of the credit risk management function.

The Credit Policy Committee s primary responsibilities include ensuring the adequacy of the Company s credit risk management infrastructure, overseeing credit risk management strategies and methodologies, monitoring conditions in real estate and other markets having an impact on lending activities, and evaluating and monitoring overall credit risk. The Chief Credit Officer s primary responsibilities include overseeing the work of the Credit Policy Committee, monitoring the credit quality of the Company s loan portfolio, determining the reasonableness of the Company s allowance for loan and lease losses, reviewing and approving large credit exposures, setting underwriting criteria for credit-related products and programs, and delegating credit approval authority.

On October 1, 2005, the Company acquired Providian Financial Corporation, a credit card lender. Credit card loans are generally unsecured and typically generate significantly higher delinquency rates and charge-offs than real estate secured loans. Consequently, the allowance for losses on credit card loans, expressed as a percentage of the credit card portfolio, is significantly higher than on real estate secured loans. Further discussion of credit risk in the Company s credit card loan portfolio can be found in Management s Discussion and Analysis Credit Card Loans .

Certain categories of residential loans held in the Company s portfolio, the most significant being Option ARM loans, have features that result in increased credit risk when compared to residential loans without these features. Loans with these features, to the extent material to the Company, as well as any compensating factors and mitigating circumstances that reduce the credit risk arising from these features, are discussed in more detail in the section of Management s Discussion and Analysis Features of Residential Loans .

Nonaccrual Loans, Foreclosed Assets and Restructured Loans

Loans, excluding credit card loans, are generally placed on nonaccrual status upon reaching 90 days past due. Additionally, loans in non-homogeneous portfolios are placed on nonaccrual status prior to becoming 90 days past due when payment in full of principal or interest is not expected. Management s classification of a loan as nonaccrual or restructured does not necessarily indicate that the principal or interest of the loan is uncollectible in whole or in part. Nonaccrual loans and foreclosed assets (nonperforming assets) and restructured loans, in each instance excluding credit card loans, consisted of the following:

	December 31, 2005	2004	2003	2002	2001
	(dollars in millions)				
Nonperforming assets and restructured loans:					
Nonaccrual loans(1)(2):					
Loans secured by real estate:					
Home	$ 565	$ 534	$ 736	$ 1,068	$ 1,010
Specialty mortgage finance(3)	872	682	597	438	292
Total home nonaccrual loans	1,437	1,216	1,333	1,506	1,302
Home equity loans and lines of credit	88	66	47	36	34
Home construction(4)	10	28	35	49	36
Multi-family	25	12	19	50	56
Other real estate	70	162	153	413	376
Total nonaccrual loans secured by real estate	1,630	1,484	1,587	2,054	1,804
Consumer	8	9	8	22	16
Commercial business	48	41	31	79	100
Total nonaccrual loans held in portfolio	1,686	1,534	1,626	2,155	1,920
Foreclosed assets	276	261	311	328	216
Total nonperforming assets	$ 1,962	$ 1,795	$ 1,937	$ 2,483	$ 2,136
As a percentage of total assets	0.57 %	0.58 %	0.70 %	0.93 %	0.88 %
Restructured loans	$ 22	$ 34	$ 111	$ 98	$ 118
Total nonperforming assets and restructured loans	$ 1,984	$ 1,829	$ 2,048	$ 2,581	$ 2,254

(1) If interest on nonaccrual loans under the original terms had been recognized, such income is estimated to have been $79 million in 2005, $64 million in 2004, $86 million in 2003 and $118 million in 2002.

(2) Nonaccrual loans held for sale, which are excluded from the nonaccrual balances presented above, were $245 million, $76 million, $66 million, $119 million and $123 million at December 31, 2005, 2004, 2003, 2002 and 2001. Loans held for sale are accounted for at lower of aggregate cost or fair value, with valuation changes included as adjustments to gain from mortgage loans.

(3) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its investment portfolio.

(4) 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.

Loans held in portfolio (excluding the allowance for loan and lease losses) and nonaccrual loans, in each instance excluding credit card loans, by geographic concentration at December 31, 2005 were as follows:

	California Portfolio	California Nonaccrual	Washington/Oregon Portfolio	Washington/Oregon Nonaccrual	New York/New Jersey Portfolio	New York/New Jersey Nonaccrual
	(dollars in millions)					
Loans secured by real estate:						
Home	$ 52,031	$ 91	$ 5,603	$ 31	$ 12,865	$ 76
Specialty mortgage finance(1)	4,864	68	817	27	2,394	100
Total home loans	56,895	159	6,420	58	15,259	176
Home equity loans and lines of credit	27,088	29	5,880	13	3,663	7
Home construction(2)	1,141		326	2	98	
Multi-family	17,609	7	1,552	7	3,673	3
Other real estate	1,926	10	913	15	830	4
Total loans secured by real estate	104,659	205	15,091	95	23,523	190
Consumer.	235	1	239	4	33	
Commercial business	324	11	170	14	310	7
Total loans held in portfolio	$ 105,218	$ 217	$ 15,500	$ 113	$ 23,866	$ 197
Loans and nonaccrual loans as a percentage of total loans and total nonaccrual loans	48 %	13 %	7 %	7 %	11 %	11 %

(1) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its investment portfolio.

(2) 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.

	Florida Portfolio	Florida Nonaccrual	Texas Portfolio	Texas Nonaccrual	Illinois Portfolio	Illinois Nonaccrual
	(dollars in millions)					
Loans secured by real estate:						
Home	$ 9,892	$ 58	$ 1,492	$ 20	$ 4,451	$ 41
Specialty mortgage finance(1)	2,034	46	1,186	78	1,093	72
Total home loans	11,926	104	2,678	98	5,544	113
Home equity loans and lines of credit	3,789	4	3,634	11	999	1
Home construction(2)	126	1	32		23	1
Multi-family	313		311	4	562	
Other real estate	80	4	539	30	4	1
Total loans secured by real estate	16,234	113	7,194	143	7,132	116
Consumer.	25	1	24		1	
Commercial business	155	2	205	6	22	
Total loans held in portfolio	$ 16,414	$ 116	$ 7,423	$ 149	$ 7,155	$ 116
Loans and nonaccrual loans as a percentage of total loans and total nonaccrual loans	7 %	7 %	3 %	9 %	3 %	7 %

(1) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its investment portfolio.

(2) 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.

	Other(3) **Portfolio** **(dollars in millions)**	**Nonaccrual**	**Total Portfolio**	**Nonaccrual**
Loans secured by real estate:				
Home	$ 27,810	$ 248	$ 114,144	$ 565
Specialty mortgage finance(1)	8,758	481	21,146	872
Total home loans	36,568	729	135,290	1,437
Home equity loans and lines of credit	5,798	23	50,851	88
Home construction(2)	291	6	2,037	10
Multi-family	1,581	4	25,601	25
Other real estate	743	6	5,035	70
Total loans secured by real estate	44,981	768	218,814	1,630
Consumer.	81	2	638	8
Commercial business	951	8	2,137	48
Total loans held in portfolio	$ 46,013	$ 778	$ 221,589 (4)	$ 1,686
Loans and nonaccrual loans as a percentage of total loans and total nonaccrual loans	21 %	46 %	100 %	100 %

(1) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its investment portfolio.

(2) 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.

(3) Of this category, Colorado had the largest portfolio balance of approximately $4.79 billion and Michigan had the largest nonaccrual amount of $76 million.

(4) Excludes credit card loans of $8.04 billion.

Credit Card Loans

In 2005, the Company acquired Providian Financial Corporation, a credit card lender. Credit cards are revolving, generally unsecured lines of credit. Credit card loans typically have much smaller balances, shorter average expected lives, higher delinquency rates and higher risk of loss than real estate secured mortgage loans. Credit card loans tend to experience both increased delinquencies and credit losses as loan balances age.

When underwriting credit card accounts, the Company sets credit limits and determines the interest rate to be charged based on a customer s credit profile and through the use of profitability and risk matrices. Such matrices are calculated using proprietary technology, statistically-derived credit risk models as well as widely accepted credit scoring and analytical tools. To offset the higher credit risk inherent in credit card loans, interest rates thereon are generally structured to generate higher yields than on real estate secured loans. The Company may also charge borrowers late fees, over-limit fees, returned payment fees and annual fees.

After a credit card account is opened, the Company regularly monitors a customer s credit risk profile and may adjust the credit limit, interest rate and other product terms in order to reflect changes in the customer s risk profile and to reduce the Company s exposure to credit loss. The Company reserves the right under its credit card account agreements to change or terminate at any time, subject to applicable notice requirements, any terms, conditions, services, or features of the agreement, including increasing or decreasing interest rates, other fees and charges, or minimum payment requirements. The Company uses a delinquency lifecycle strategy, in combination with event-driven approaches, consumer counseling, and consumer debt management programs, to manage delinquent accounts. The Company s collection efforts are prioritized to focus on delinquent loans.

Features of Residential Loans

Certain residential loans have features that may result in increased credit risk when compared to residential loans without those features. Categories of loans within the Company s portfolio that have such

features include loans with an option to defer the payment of interest (i.e., Option ARM home loans), home loans where the loan-to-value ratio is greater than 80 percent, home equity loans and lines of credit where the combined loan-to-value ratio is greater than 80 percent, and interest-only payment loans. The loan-to-value ratio measures the ratio of the original loan amount to the appraised value of the collateral at origination. 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 collateral that underlies the loan the Company is originating.

In the underwriting of these loans, the Company usually considers compensating factors and mitigating circumstances that may serve to reduce the potential for increased credit risk arising from these features. Loan balances for these categories of loans and their relative significance as a percentage of total loans held in portfolio (excluding the allowance for loan and lease losses) at December 31, 2005, is presented in the table below:

	Loan Balance (in millions)	**As a % of Total Loans Held in Portfolio**
Option ARM home loans	$ 70,191	31 %
Home loans without private mortgage insurance or government guarantees where the loan-to-value ratio at origination is greater than 80 percent	9,012	4
Home equity loans and lines of credit where the combined loan-to-value ratio at origination is greater than 80 percent	12,312	5
Interest-only home loans	10,660	5

Option ARM Home Loans

Loan Features

The Option ARM product is an adjustable-rate mortgage loan that each month provides the borrower with the option to make a fully-amortizing, interest-only, or minimum payment. The minimum payment on an Option ARM loan is based on the interest rate charged during the introductory period. This introductory rate is usually significantly below the fully-indexed rate for loans with short duration introductory periods (which typically last for one or three months depending on the type of Option ARM loan selected by the borrower). 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 the loan s anniversary date but can only increase or decrease by a maximum of 7.5% on such date until a recasting event occurs.

Recasting events occur at least every 60 months, at which time a new minimum monthly payment is calculated without regard to any limits on the increase 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 immediately occurs whenever the unpaid principal balance reaches 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.

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 could once again limit the change in the minimum payment until the next recasting event.

If borrowers with Option ARM loans continue to make monthly payments in accordance with the terms of their loan agreements, the loans will continue to accrue interest based on the fully-indexed rate.

Loan Performance

Trends in loan performance and risk attributes such as loan-to-value ratios, credit scores, negative amortization, minimum payment adjustments, degree of minimum payment utilization, and geographic concentrations are monitored and analyzed as part of the Company s credit risk management process. Interest rates, housing price trends and other economic variables are also taken into consideration when modeling these risks. Credit scores are a useful measure for assessing the credit quality of a borrower. Credit scores are numbers reported by credit repositories, based on statistical models, that summarize an individual s credit record. FICO® scores, developed by Fair Isaac Corporation, are the most commonly used credit scores.

Key statistics for Option ARM loans held in the Company s home loan portfolio include:

	December 31, 2005		2004		2003	
	(dollars in millions)					
Loan balance	$ 70,191		$ 66,310		$ 49,267	
Loan volume(1)	63,260		67,485		30,092	
Deferred interest recognized in earnings that resulted from negative amortization(1)	316		19		7	
Total amount by which the unpaid principal balance exceeded the original principal amount	157		11		43	
Balance of loans that experienced a net increase in negative amortization during the year	43,856		18,364		959	
Percentage of borrowers whose final loan payment of the year resulted in negative amortization:						
By number of loans	47	%	21	%	1	%
By value of loans	55		25		1	

(1) For the year.

The geographic distribution of the Company s Option ARM portfolio is set forth in the table below:

	Portfolio (dollars in millions)			Weighted Average Loan-to-Value Ratio at Origination	
California	$ 33,875	48	%	70	%
Florida	7,253	10		71	
New York/New Jersey	7,043	10		70	
Washington/Oregon	2,615	4		74	
Illinois	1,972	3		74	
Texas	735	1		75	
Other	16,698	24		72	
Total home loan Option ARMs held in portfolio	$ 70,191	100	%	71	

Underwriting and Risk Mitigation

The Company actively manages the credit risk inherent in its Option ARM portfolio primarily by ensuring compliance with its underwriting standards, monitoring loan performance and conducting risk modeling procedures. Risk attributes and compensating factors, which may include an applicant s credit score, the loan-to-value ratio, loan size and debt-to-income ratio, are taken into consideration as part of the underwriting process. The Company s practices of not offering Option ARM loans through its specialty mortgage finance lending program and of selectively selling Option ARM loans to secondary market participants have further limited the potential for credit risk in its Option ARM portfolio.

In the underwriting of loans, one of many factors the Company considers when deciding whether to approve or decline a loan is the applicant s debt-to-income ratio. The Company s underwriting process for Option ARM loans has historically involved calculating an applicant s debt-to-income ratio using an administratively set interest rate. Prior to 2004, the administratively set rate approximated the then-prevailing fully-indexed rate. However, as short-term interest rates (and hence the fully-indexed rate) increased in 2004 and 2005, the Company s administratively set qualifying rate was not adjusted upward, which resulted in loans being made to borrowers who were qualified based on debt-to-income ratios calculated using an interest rate below the fully-indexed rate. The administratively set rate was adjusted upward in October 2005, and beginning in mid-December 2005, it was replaced with a fully-indexed rate that adjusts monthly for changes in the index rate.

The Company s experience shows that debt-to-income ratios are less predictive of loan performance than credit scores and loan-to-value ratios, which the Company believes are the two key determinants in forecasting future loan performance. Therefore, having considered the credit scores and loan-to-value ratios of the Option ARM loans made to borrowers who were qualified based on debt-to-income ratios calculated using an interest rate below the fully-indexed rate, the Company expects that the credit performance of these loans will not differ materially from the expected performance of Option ARM loans qualified using the fully-indexed rate.

Option ARM loans originated in 2004 and 2005 and held in portfolio at December 31, 2005 had an unpaid principal balance of $42.87 billion, a weighted average FICO score of 681 and a weighted average loan-to-value ratio at origination of 72 percent. Of such loans, the unpaid principal balance for borrowers who were qualified at below the fully-indexed rate totaled $29.97 billion, with a weighted average FICO score of 685 and a weighted average loan-to-value ratio at origination of 72 percent.

Risk mitigation activities include proactive risk management strategies such as re-designating Option ARM loans from held in portfolio to held for sale (prior to selling the loans in the secondary market), such as occurred during 2005 when the Company sold approximately $3 billion of Option ARM loans that were originally held in its loan portfolio. Additionally, the 60-month recasting feature that is inherent within the Option ARM product serves to limit the amount of negative amortization. The Company did not conduct risk mitigation activities that involved the use of insurance arrangements, credit default agreements or credit derivatives during 2005.

Impact of External Factors

Certain external factors have, over the last five years, contributed to a reduction in the credit risk inherent in the Option ARM portfolio. The two most significant economic factors affecting the Option ARM portfolio are prepayment rates, which operate to reduce the risk of payment shock in the portfolio caused by the 60-month recasting event, and changes in housing prices, which affect current loan-to-value ratios. The risk of payment shock is reduced because many Option ARM borrowers will prepay their loans prior to the occurrence of the first 60-month recasting event. Furthermore, credit risk usually diminishes when housing prices appreciate. Option ARM loans originated prior to 2005 have benefited from a longer period of housing price appreciation than loans originated in 2005; with such earlier originations

accounting for 62% by balance and 71% by number of Option ARM loans held in portfolio at December 31, 2005, current loan-to-value ratios have generally improved in many cases offsetting the credit risk associated with negative amortization that may have resulted from the borrower s use of the minimum payment option.

Home Loans with Loan-to-Value Ratios Greater Than 80 percent Without Private Mortgage Insurance or Government Guarantees

Loan-to-value ratios are a key determinant of future performance. Home loans with loan-to-value ratios of greater than 80 percent at origination without private mortgage insurance or government guarantees expose the Company to greater credit risk than home loans with loan-to-value ratios of 80 percent or less at origination. Credit risk is also reduced when the loan amount above 80 percent of the collateral value is guaranteed by the government or is insured under a policy of private mortgage insurance purchased by the borrower. This greater credit risk arises because, in general, both default risk and the severity of loss is higher when borrowers have less equity to protect in the event of foreclosure. At December 31, 2005, home loans held in portfolio with these features amounted to $9.01 billion and the weighted average loan-to-value ratio at origination of such loans was 88 percent. Substantially all of these loans were made to subprime borrowers, including $6.91 billion of purchased subprime loans. Total home loans with these features accounted for 10% of the Company s home loan volume in 2005.

The Company actively monitors conditions in housing markets in which it has a concentration of home loans. Geographic concentrations are taken into account when deciding which home loans to sell in the secondary market. Only $604 million, or 0.4% of home loans held in portfolio at December 31, 2005, had no private mortgage insurance or government guarantees and had loan-to-value ratios in excess of 90 percent at origination. The highest proportion of these loans was secured by properties in California, a market in which housing prices have generally appreciated over the last five years.

Typically, borrowers requesting financing with loan-to-value ratios of greater than 80 percent without government guarantees are required to purchase private mortgage insurance from a third party. In the event of default, the Company can recover losses from the private mortgage insurer. Alternatively, under certain loan programs, qualifying customers can elect to pay a higher interest rate to the Company in lieu of paying for private mortgage insurance. This higher interest rate is expected to compensate the Company for the incremental credit risk inherent in lending to borrowers without private mortgage insurance.

The Company seeks to mitigate credit risk in its purchased subprime loan portfolio by requiring minimum credit scores and by re-underwriting all such loans. Furthermore, with limited exceptions, the Company does not purchase loans through this program that have loan-to-value ratios of greater than 90 percent.

Home Equity Loans and Lines of Credit where the Combined Loan-to-Value Ratio is Greater Than 80 percent

Instead of undertaking cash-out refinance transactions, many borrowers have elected to leverage increasing amounts of equity in their homes by borrowing money through either a first or second lien home equity loan or line of credit. The existence of a first lien mortgage loan and second lien home equity loan or line of credit made to one borrower and secured by the same property, most often arises when the Company:

- Simultaneously originates the first lien mortgage loan and second lien home equity loan or line of credit (so called piggyback loans);
- Originates or purchases the first lien mortgage loan and at a subsequent date originates a second lien home equity loan or line of credit;

- Originates a second lien home equity loan or line of credit subordinate to another lender s first lien mortgage loan.

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 default and severity of loss risk is 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 default 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. By taking this action, the second lien holder increases its exposure to greater loss on liquidation of the collateral.

The balance of home equity loans and lines of credit with combined loan-to-value ratios of greater than 80 percent at origination totaled $12.31 billion at December 31, 2005 and accounted for 37% of the Company s home equity volume in 2005. Substantially all of this portfolio had a combined loan-to-value ratio at origination of between 80 and 90 percent.

To compensate for the increased credit risk in the home equity portfolio that arises where the combined loan-to-value ratio at origination is greater than 80 percent, the Company typically charges such borrowers a higher rate of interest than would be charged if the combined loan-to-value ratio at origination was less than 80 percent. The Company also buys pool mortgage insurance that insulates it from the risk of default on those home equity loans or lines of credit where the combined loan-to-value ratio at origination is greater than 90 percent.

Interest-only Payment Home Loans

Borrowers with interest-only loans are initially required to make monthly payments that are sufficient to cover the full amount of contractual interest accrued in the previous month. After a predetermined period of time (usually 5 years), the payment is reset to allow the loan to fully-amortize over its remaining life. The Company held $10.66 billion of interest-only home loans in portfolio at December 31, 2005. Loans with these features accounted for 8% of the Company s home loan volume in 2005. Borrowers with interest-only loans generally have the highest credit ratings, lowest weighted average loan-to-value ratios at origination and the most favorable delinquency statistics of all loan programs in the Company s home loan portfolio. Compared to fully-amortizing loan products, interest-only loans originated by the Company contain other restrictions such as lower maximum loan-to-value ratios and lower maximum loan levels. Borrowers with interest-only loans are also charged a higher interest rate to compensate for the potentially higher credit risk.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses represents management s estimate of incurred credit losses inherent in the Company s loan and lease portfolios as of the balance sheet date. The estimation 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 the borrowers ability to repay, the estimated value of underlying collateral, the interest rate climate as it affects adjustable-rate loans and general economic conditions. Determining the adequacy 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 and lease losses in future periods.

The allowance provides for incurred losses that are inherent in the loan portfolio. Losses are recognized when (a) available information indicates that it is probable that a loss has been incurred and (b) the amount of the loss can be reasonably estimated. Generally, borrowers are impacted by events that

result in loan default and eventual loss well in advance of a lender s knowledge of those events. Examples of such loss-causing events for home loans are borrower job loss, divorce and medical crisis. An example for commercial real estate loans would be the loss of a major tenant.

In determining the allowance for loan and lease losses, the Company allocates a portion of the allowance to its various loan product categories based on an analysis of individual loans and pools of loans. However, the entire allowance (both the allocated component and the portion that remains unallocated) is available to absorb credit losses inherent in the total loan portfolio as of the balance sheet date.

The allocated allowance for homogeneous loans (such as home loans, home equity loans and lines of credit, specialty mortgage finance loans and credit card loans) is determined using statistical forecasting models that estimate default and loss outcomes based on an evaluation of past performance of loans in the Company s portfolio and other factors as well as industry historical loan loss data. Management periodically reviews these models for reasonableness and updates the assumptions used in these models.

Non-homogeneous loans (such as multi-family and non-residential real estate loans) are individually reviewed and assigned a risk grade. The loans are then categorized by their risk grade into pools, with each pool having a pre-assigned loss factor commensurate with the applicable level of estimated risk. Loss factors are then multiplied by the unpaid principal balance of loans in each pool to determine the allocated allowance applicable to that pool.

The Company also evaluates certain loans on an individual basis for impairment (as defined by Statement No. 114, *Accounting by Creditors for Impairment of a Loan*) and records an allowance for impaired loans as appropriate. Such loans are excluded from other loan loss analyses so as to avoid double counting the loss exposure.

To mitigate the imprecision inherent in estimates of credit losses, the allocated component of the allowance is supplemented by an unallocated component. The unallocated component reflects management s assessment of various risk factors that are not adequately reflected in the models used to determine the allocated component of the allowance. These factors include general economic and business conditions affecting its key lending products and markets, credit quality and collateral value trends, loan concentrations, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle and the impact of new product initiatives and other such variables for which recent historical performance does not reflect the risk profile of the portfolio.

Changes in the allowance for loan and lease losses were as follows:

	Year Ended December 31,				
	2005	2004	2003	2002	2001
	(dollars in millions)				
Balance, beginning of year	$ 1,301	$ 1,250	$ 1,503	$ 1,278	$ 909
Allowance transferred to loans held for sale	(270)	(23)	(3)	(31)	
Allowance acquired through business combinations	592			148	120
Other			17	(48)	
Provision for loan and lease losses(1)	316	209	42	404	426
	1,939	1,436	1,559	1,751	1,455
Loans charged off:					
Loans secured by real estate:					
Home	(38)	(39)	(65)	(52)	(29)
Specialty mortgage finance(2)	(50)	(39)	(39)	(33)	(25)
Total home loans charged off	(88)	(78)	(104)	(85)	(54)
Home equity loans and lines of credit	(30)	(22)	(14)	(14)	(4)
Home construction(3)	(1)	(1)	(2)	(1)	
Multi-family	(1)	(2)	(5)	(1)	
Other real estate	(8)	(11)	(97)	(60)	(35)
Total loans secured by real estate	(128)	(114)	(222)	(161)	(93)
Consumer:					
Credit card	(138)				
Other	(38)	(53)	(69)	(70)	(51)
Commercial business	(34)	(21)	(79)	(73)	(49)
Total loans charged off	(338)	(188)	(370)	(304)	(193)
Recoveries of loans previously charged off:					
Loans secured by real estate:					
Home			10	2	2
Specialty mortgage finance(2)	3	3	3		
Total home loan recoveries	3	3	13	2	2
Home equity loans and lines of credit	9	4	1	1	1
Multi-family	3	3	1	1	
Other real estate	13	10	17	12	3
Total loans secured by real estate	28	20	32	16	6
Consumer:					
Credit card	40				
Other	19	19	15	13	4
Commercial business	7	14	14	27	6
Total recoveries of loans previously charged off	94	53	61	56	16
Net charge-offs	(244)	(135)	(309)	(248)	(177)
Balance, end of year	$ 1,695	$ 1,301	$ 1,250	$ 1,503	$ 1,278
Net charge-offs as a percentage of average loans held in portfolio	0.11 %	0.07 %	0.20 %	0.17 %	0.14 %
Allowance as a percentage of total loans held in portfolio	0.74	0.63	0.71	1.05	1.01

(1) Includes a $202 million reversal of provision for loan and lease losses recorded in the fourth quarter of 2003.

(2) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its 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.

The risk profile of the Company s loan portfolio changed significantly during 2001 and 2002. In a five quarter span from January 2001 to March 31, 2002, the Company consummated four purchase business combinations: Bank United Corp. (Bank United), the mortgage operations of The PNC Financial Services Group, Inc., Fleet Mortgage Corp. and Dime Bancorp, Inc. (Dime). As a result of these acquisitions, the Company s loan portfolio contained substantially higher levels of credit risk. In particular, Bank United s commercial lending activities were concentrated in underperforming sectors of the economy, such as assisted living facilities, Small Business Administration loans and highly leveraged syndicated lending. This change in the loan portfolio composition was exacerbated by the downturn in the national economy, which continued to worsen following the events of September 11, 2001.

Although the national economy showed some intermittent signs of stabilizing performance in 2002, the overall climate was still one of significant uncertainty, as demonstrated by the continuing high levels of unemployment, distressed levels of consumer confidence and continuing concerns of housing price bubbles in some of the Company s real estate markets. After their substantial growth in 2001, nonperforming asset trends stabilized in 2002 but remained at elevated levels, decreasing slightly to $2.48 billion at December 31, 2002 after reaching a first quarter peak of $2.68 billion. Though the Company continued to provision at levels that exceeded net charge-offs as a result of the continuing economic malaise, the gap between these statistical measures had declined from $74 million in the first quarter of 2002 to $2 million by the fourth quarter of that year. This reflected the Company s cautious belief that, while the economy had not demonstrated signals of a sustained economic recovery, it at least did not appear to be deteriorating any further. This assessment was also evident in the quarterly trend of the allowance for loan and lease losses as a percentage of total loans held in portfolio. After growing steadily from 0.82% in the first quarter of 2001 to 1.08% in the second quarter of 2002, it stabilized during the remainder of that year, ending at 1.05% at December 31, 2002.

During 2003, nonperforming assets declined from $2.48 billion at the beginning of the year to $1.94 billion at December 31, 2003. Beginning in the fourth quarter of 2002, the Company initiated a program of periodically selling nonperforming assets in order to reduce its exposure to potential credit losses. This program continued throughout 2003 with the sale of $619 million of nonperforming loans and was substantially the reason for the decline in nonperforming assets. Charge-offs sustained from sales of these loans were, in general, at lower levels than the Company believes it would have incurred had these loans been allowed to season further.

As economic conditions improved during 2003, the Company s assessment of the economic climate progressed from one of continuing concern in the first quarter of 2003 to one of guarded optimism by the third quarter of that year. However, a discernable, positive trend was not evident until various economic statistics were released in the fourth quarter. Those statistics provided conclusive evidence that key economic indicators that affect the Company s credit risk profile had improved. Those indicators included a stable interest rate environment, a consistent pattern of stable or increasing housing prices, strong levels of residential home construction, lower unemployment levels, increasing capital expenditures, steady to improving corporate profits and stronger levels of exports from a weakening U.S. dollar. These favorable external factors were augmented by the Company s ability to sell its underperforming franchise finance loan portfolio in the fourth quarter of 2003 at a price that exceeded its carrying value by $82 million. As a result of all of these events, the Company determined that a $202 million reversal of the provision for loan and lease losses in the fourth quarter of 2003 was appropriate.

During 2004, strong loan portfolio growth, especially in the higher-risk purchased subprime portfolio, resulted in management recording a provision for loan and lease losses that exceeded net charge-offs by $74 million. However, as a reflection of the continuing favorable trend in key domestic economic indicators which facilitated a relatively benign credit environment throughout the year, the allowance for loan and lease losses as a percentage of loans held in portfolio declined from 0.71% at December 31, 2003 to 0.63% at December 31, 2004. The positive economic outlook was also affirmed by the Federal Reserve s decision

to initiate a series of measured increases in the targeted Federal Funds rate during the second half of 2004, thus reducing the degree of stimulus that the Federal Reserve believes is necessary to sustain continuing economic growth.

The allowance for loan and lease losses increased by $394 million from $1.30 billion at December 31, 2004 to $1.70 billion at December 31, 2005 largely reflecting the addition of the credit card portfolio of the former Providian Financial Corporation on October 1, 2005. Credit card loans are generally unsecured and typically generate significantly higher delinquency rates and charge-offs than real estate secured loans and the allocated allowance for losses on credit card loans, expressed as a percentage of the credit card portfolio, is consequently significantly higher than on real estate secured loans. Largely as a result of the addition of a credit card portfolio, the total allowance for loan and lease losses expressed as a percentage of total loans held in portfolio, increased from 0.63% at December 31, 2004 to 0.74% at December 31, 2005. The overall economic environment surrounding the Company s lending operations during 2005 was relatively stable despite increases in short-term interest rates, with a generally healthy business climate and continued strength in employment levels and real estate markets nationally.

An analysis of the allowance for loan and lease losses was as follows:

	December 31, 2005			2004			2003		
	Allowance for Loan and Lease Losses	**Allocated Allowance as a % of Loan Category**	**Loan Category as a % of Total Loans(1)**	**Allowance for Loan and Lease Losses**	**Allocated Allowance as a % of Loan Category**	**Loan Category as a % of Total Loans(1)**	**Allowance for Loan and Lease Losses**	**Allocated Allowance as a % of Loan Category**	**Loan Category as a % of Total Loans(1)**
	(dollars in millions)								
Allocated allowance:									
Loans secured by real estate:									
Home	$ 222	0.19%	49.71 %	$ 215	0.20%	53.12 %	$ 321	0.32%	57.12 %
Specialty mortgage finance(2)	373	1.77	9.21	242	1.26	9.24	84	0.65	7.41
Total home loans	595	0.44	58.92	457	0.35	62.36	405	0.36	64.53
Home equity loans and lines of credit	107	0.21	22.14	83	0.19	21.08	82	0.30	15.78
Home construction(3)	6	0.29	0.89	12	0.51	1.13	18	0.81	1.27
Multi-family	122	0.48	11.15	101	0.45	10.76	139	0.68	11.60
Other real estate	69	1.37	2.19	116	2.05	2.74	110	1.65	3.80
Total allocated allowance secured by real estate	899	0.41	95.29	769	0.38	98.07	754	0.44	96.98
Consumer:									
Credit card	328	4.08	3.50						
Other	27	4.25	0.28	36	4.55	0.38	49	4.77	0.59
Commercial business	44	2.03	0.93	51	1.59	1.55	72	1.69	2.43
Total allocated allowance held in portfolio	1,298	0.57	100.00	856	0.41	100.00	875	0.50	100.00
Unallocated allowance	397	0.17		445	0.22		375	0.21	
Total allowance for loan and lease losses	$ 1,695	0.74%	100.00%	$ 1,301	0.63%	100.00%	$ 1,250	0.71%	100.00%

(Continued on next table.)

(1) Excludes loans held for sale.

(2) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its 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.

	December 31, 2002 Allowance for Loan and Lease Losses (dollars in millions)	Allocated Allowance as a % of Loan Category	Loan Category as a % of Total Loans(1)	2001 Allowance for Loan and Lease Losses	Allocated Allowance as a % of Loan Category	Loan Category as a % of Total Loans(1)
Allocated allowance:						
Loans secured by real estate:						
Home	$ 251	0.30 %	57.92 %	$ 290	0.36 %	63.00 %
Specialty mortgage finance(2)	169	1.67	7.08	97	1.18	6.49
Total home loans	420	0.45	65.00	387	0.44	69.49
Home equity loans and lines of credit	46	0.29	11.31	27	0.34	6.31
Home construction(3)	22	1.13	1.36	32	1.23	2.05
Multi-family	146	0.81	12.59	138	0.88	12.35
Other real estate	296	3.71	5.58	161	2.64	4.82
Total allocated allowance secured by real estate	930	0.68	95.84	745	0.62	95.02
Consumer:						
Credit card						
Other	70	4.21	1.16	71	3.53	1.59
Commercial business	116	2.70	3.00	92	2.15	3.39
Total allocated allowance held in portfolio	1,116	0.78	100.00	908	0.72	100.00
Unallocated allowance	387	0.27		370	0.29	
Total allowance for loan and lease losses	$ 1,503	1.05 %	100.00 %	$ 1,278	1.01 %	100.00 %

(1) Excludes loans held for sale.

(2) Represents purchased subprime home loan portfolios and subprime home loans originated by Long Beach Mortgage Company and held in its 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.

Growth in the Company s specialty mortgage finance portfolio since 2001 has resulted in a substantial increase in the allocated allowance attributable to this portfolio and a substantial increase in nonaccrual loans. The Company seeks to mitigate the credit risk in this portfolio by ensuring compliance with underwriting standards on loans originated to subprime borrowers and by re-underwriting all purchased subprime loans. During 2005, while the size of this portfolio grew by $1.97 billion or 10%, nonaccrual loans and net charge-offs expressed as a percentage of the loan category increased by 16% and 18%, and as a result, the allocated allowance increased from 1.26% of specialty mortgage finance loans held in portfolio to 1.77%.

Home equity loans and lines of credit increased from $7.97 billion at December 31, 2001 to $50.85 billion at December 31, 2005. With the strong housing market that has existed during the current decade, home equity loans and lines of credit have become an increasingly popular product as they enable homeowners to borrow a portion of their equity for personal expenditures. Although the allocated allowance for this portfolio increased from $27 million at December 31, 2001 to $107 million at the end of 2005, that allowance as a percentage of loans in this portfolio declined from 0.34% to 0.21% during that same period, reflecting generally high credit scores among borrowers, lower risk loan-to-value ratios and a significant portion of loans that are in a first lien position.

90 or More Days Past Due and Still Accruing

The total amount of loans held in portfolio, excluding credit card loans, that were 90 days or more contractually past due and still accruing interest was $107 million, $85 million, $46 million, $60 million and $86 million at December 31, 2005, 2004, 2003, 2002 and 2001. The majority of these loans are either VA- or FHA-insured with little or no risk of loss of principal or interest. Credit card loans held in portfolio that were 90 days or more contractually past due and still accruing interest were $87 million at

December 31, 2005. Credit card loans are charged-off when they are determined to be uncollectible or by the end of the month in which the account becomes 180 days past due.

As a result of regulatory guidelines issued in 2003, delinquent mortgages contained within GNMA servicing pools that are repurchased or are eligible to be repurchased by the Company must be reported as loans on the Consolidated Statements of Financial Condition. As the Company sells most of these repurchased loans to secondary market participants, they are classified as loans held for sale on the Consolidated Statements of Financial Condition. Substantially all of these loans are either guaranteed or insured by agencies of the federal government and, therefore, do not expose the Company to significant risk of credit loss. The Company s held for sale portfolio contained $1.06 billion, $1.60 billion, $2.50 billion, $3.22 billion and $692 million of such loans that were 90 days or more contractually past due and still accruing interest at December 31, 2005, 2004, 2003, 2002 and 2001.

Liquidity Risk Management

The objective of liquidity management is to ensure the Company has the continuing ability to maintain cash flows that are adequate to fund operations and meet its other obligations on a timely and cost-effective basis. The Company establishes liquidity guidelines for the parent holding company, Washington Mutual, Inc., as well as for its principal operating subsidiaries. The Company also maintains contingency liquidity plans that outline alternative actions and enable appropriate and timely responses under stress scenarios.

Washington Mutual, Inc.

Liquidity for Washington Mutual, Inc. (the Parent Company) is generated through its ability to raise funds through dividends from subsidiaries and in various capital markets through the issuance of unsecured debt, commercial paper and other securities.

One of Washington Mutual, Inc. s key funding sources is from dividends paid by its banking subsidiaries. Banking subsidiaries dividends may be reduced from time to time to ensure that internal capital targets are met. Various regulatory requirements related to capital adequacy and retained earnings also limit the amount of dividends that can be paid by the Parent Company s banking subsidiaries. For more information on such dividend limitations applicable to the Company s banking subsidiaries, refer to Business Regulation and Supervision and Note 19 to the Consolidated Financial Statements Regulatory Capital Requirements and Dividend Restrictions.

In January 2006, the Company filed an automatically effective registration statement under the Securities Offering Reform rules recently adopted by the SEC. The Company registered an unlimited amount of debt securities and preferred stock on this registration statement.

Washington Mutual, Inc. also has a commercial paper program and a revolving credit facility that are sources of liquidity. At December 31, 2005, the commercial paper program provided for up to $1 billion in funds. In addition, the Company s revolving credit facility of $800 million provides credit support for Washington Mutual, Inc. s commercial paper program as well as funds for general corporate purposes. At December 31, 2005, Washington Mutual, Inc. had $671 million in commercial paper available for issuance and the entire amount of the revolving credit facility was available.

The Parent Company s senior debt and commercial paper was rated A and F1 by Fitch, A3 and P2 by Moody s and A- and A2 by Standard and Poor s.

Washington Mutual, Inc. maintains sufficient liquidity to cover all debt obligations maturing over the next twelve months.

Banking Subsidiaries

The principal sources of liquidity for the Company s banking subsidiaries are customer deposits, wholesale borrowings, the maturity and repayment of portfolio loans, securities held in the available-for-sale portfolio and mortgage loans designated as held for sale. Among these sources, transaction account deposits and wholesale borrowings from FHLB advances, repurchase agreements and federal funds purchased continue to provide the Company with a significant source of stable funding. During 2005, those sources funded 65% of average total assets. The Company s continuing ability to retain its transaction account deposit base and to attract new deposits depends on various factors, such as customer service satisfaction levels and the competitiveness of interest rates offered on deposit products. The Company continues to have the necessary assets available to pledge as collateral to obtain additional FHLB advances and repurchase agreements to offset potential declines in deposit balances.

At December 31, 2005, the Company s proceeds from the sales of loans were approximately $167 billion. These proceeds were, in turn, used as the primary funding source for the origination and

purchases, net of principal payments, of approximately $165 billion of loans held for sale during the same period. Typically, a cyclical pattern of sales and originations/purchases repeats itself during the course of a period and the amount of funding necessary to sustain mortgage banking operations does not significantly affect the Company s overall level of liquidity resources.

The Company s banking subsidiaries also raise funds in domestic and international capital markets to supplement their primary funding sources. In August 2003, the Company established a Global Bank Note Program that allows Washington Mutual Bank to issue senior and subordinated notes in the United States and in international capital markets in a variety of currencies and structures. The program was renewed in December 2005. Washington Mutual Bank had $22 billion available under this program at December 31, 2005.

Senior unsecured long-term obligations of Washington Mutual Bank were rated A by Fitch, A2 by Moody s and A by Standard and Poor s. Short-term obligations were rated F1 by Fitch, P1 by Moody s and A1 by Standard and Poor s.

Non-banking Subsidiaries

Long Beach Mortgage Company has revolving credit facilities with non-affiliated lenders totaling $6.5 billion that are used to fund loans held for sale. At December 31, 2005, Long Beach Mortgage Company had borrowings outstanding of approximately $2.8 billion under these credit facilities.

In June 2005, Long Beach Mortgage Company launched Strand Capital LLC (Strand), a single-seller asset-backed extendible note facility, to augment its existing credit facilities. Strand has total funding capacity of $9.5 billion, and as of December 31, 2005 approximately $4.2 billion in notes were outstanding.

Market Risk Management

Market risk is defined as the sensitivity of income, fair market values and capital to changes in interest rates, foreign currency exchange rates, commodity prices and other relevant market rates or prices. The primary market risk to which the Company is exposed is interest rate risk. Substantially all of its interest rate risk arises from instruments, positions and transactions entered into for purposes other than trading. These include loans, MSR, securities, deposits, borrowings, long-term debt and derivative financial instruments.

The Company s trading assets are primarily comprised of financial instruments that are retained from securitization transactions, or are purchased for MSR risk management purposes. The Company does not take significant short-term trading positions for the purpose of benefiting from price differences between financial instruments and markets.

Interest rate risk is managed within a consolidated enterprise risk management framework that includes asset/liability management and the management of specific portfolios (MSR and Other Mortgage Banking) discussed below. The principal objective of asset/liability management is to manage the sensitivity of net income to changing interest rates. Asset/liability management is governed by a policy reviewed and approved annually by the Board. The Board has delegated the oversight of the administration of this policy to the Finance Committee of the Board.

Types of Interest Rate Risk

The Company is exposed to different types of interest rate risks. These include lag, repricing, basis, prepayment, lifetime and periodic payment caps, and volatility risk.

Lag/Repricing Risk

Lag risk results from timing differences between the repricing of adjustable-rate assets and liabilities. Repricing risk is caused by the mismatch in the maturities between assets and liabilities. For example, the

Company s assets may reprice slower than its liabilities. The effect of this timing difference, or lag, will be favorable during a period of declining interest rates and unfavorable during a period of rising interest rates. Lag/repricing risk can produce short-term volatility in net interest income during periods of interest rate movements, but the effect of this lag generally balances out over time.

Basis Risk

Basis risk occurs when assets and liabilities have similar repricing frequencies but are tied to different market interest rate indices. For example, adjustable-rate loans may reprice based on Treasury rates while borrowings may reprice based on LIBOR rates.

Prepayment Risk

Prepayment risk results from the ability of customers to pay off their loans prior to maturity. Generally, prepayments increase in falling interest rate environments and decrease in rising interest rate environments.

Lifetime and Periodic Payment Cap Risk

Many of the Company s adjustable-rate home loan products contain lifetime interest rate caps, which prevent the interest rate on the loan from exceeding a contractually determined level. In periods of dramatically rising rates, those adjustable-rate loans that have reached their lifetime cap rate will no longer reprice upward. Periodic payment caps limit the amount that a borrower s scheduled payment on an adjustable-rate loan can increase when the interest rate is adjusted upward on the loan s periodic repricing date.

Volatility Risk

Volatility risk is the potential change in the fair value of an option, or a fixed income instrument containing options (such as mortgages) from changes in the implied market level of future volatility (implied volatility). For the holder of an option contract, implied volatility is a key determinant of option value with higher volatility generally increasing option value and lower volatility generally decreasing option value.

MSR Risk Management

The Company manages potential impairment in the fair value of MSR and increased amortization levels of MSR through a comprehensive risk management program. The intent is to offset the changes in MSR fair value and changes in MSR amortization above anticipated levels with changes in the fair value of risk management instruments. The risk management instruments include interest rate contracts, forward purchase commitments and available-for-sale and trading securities. The securities generally consist of fixed-rate debt securities, such as U.S. Government and agency obligations and mortgage-backed securities, including principal-only strips. The interest rate contracts typically consist of interest rate swaps, interest rate swaptions, interest rate floors and interest rate caps. The Company may purchase or sell option contracts, depending on the portfolio risks it seeks to manage. The Company also enters into forward commitments to purchase and sell mortgage-backed securities, which generally are comprised of fixed-rate mortgage-backed securities with 15 or 30 year maturities.

The fair value of MSR is primarily affected by changes in prepayments that result from shifts in mortgage rates. Changes in the value of MSR risk management instruments vary based on the specific instrument. For example, changes in the fair value of interest rate swaps are driven by shifts in interest rate swap rates and the fair value of U.S. Treasury securities is based on changes in U.S. Treasury rates. Mortgage rates may move more or less than the rates on Treasury bonds or interest rate swaps. This could result in a change in the fair value of the MSR that differs from the change in fair value of the MSR risk

management instruments. This difference in market indices between the MSR and the risk management instruments results in what is referred to as basis risk.

The fair value of MSR decreases and the amortization rate increases in a declining interest rate environment due to higher prepayment activity. During periods of rising interest rates, the amortization rate of MSR decreases and the fair value of MSR increases due to lower prepayment activity.

The Company manages the MSR daily and adjusts the mix of instruments used to manage MSR fair value changes as interest rates and market conditions warrant. The objective is to maintain an efficient and fairly liquid mix as well as a diverse portfolio of risk management instruments with maturity ranges that correspond well to the anticipated behavior of the MSR. For that portion of the MSR which qualifies for hedge accounting treatment, all changes in fair value of the MSR, even when the fair value is higher than amortized cost, will be recorded through earnings. MSR which do not qualify for hedge accounting treatment must be accounted for at the lower of cost or fair value. The Company also manages the size of the MSR asset. Depending on market conditions and the desire to expand customer relationships, management may periodically sell or purchase additional servicing. Management may also structure loan sales to control the size of the MSR asset created by any particular transaction.

The Company believes this overall risk management strategy is the most efficient approach to managing MSR fair value risk. The success of this strategy, however, is dependent on management s decisions regarding the amount, type and mix of MSR risk management instruments that are selected to manage the changes in fair value of the mortgage servicing asset. If this strategy is not successful, net income could be adversely affected.

Other Mortgage Banking Risk Management

The Company also manages the risks associated with its home loan mortgage warehouse and pipeline. The mortgage warehouse consists of funded loans intended for sale in the secondary market. The pipeline consists of commitments to originate or purchase mortgages to be sold in the secondary market. The risk associated with the mortgage pipeline and warehouse is the potential for changes in interest rates between the time the customer locks in the rate on the loan and the time the loan is sold.

The Company measures the risk profile of the mortgage warehouse and pipeline daily. To manage the warehouse and pipeline risk, management executes forward sales commitments, interest rate contracts and mortgage option contracts. A forward sales commitment protects against a rising interest rate environment, since the sales price and delivery date are already established. A forward sales commitment is different, however, from an option contract in that the Company is obligated to deliver the loan to the third party on the agreed-upon future date. Management also estimates the fallout factor, which represents the percentage of loans that are not expected to be funded, when determining the appropriate amount of pipeline risk management instruments.

Asset/Liability Risk Management

The purpose of asset/liability risk management is to assess the aggregate interest rate risk profile of the Company. Asset/liability risk analysis combines the MSR and Other Mortgage Banking activities with substantially all of the other remaining interest rate risk positions inherent in the Company s operations.

To analyze net income sensitivity, management projects net income in a variety of interest rate scenarios, assuming both parallel and non-parallel shifts in the yield curve. These scenarios illustrate net interest income sensitivity that results from changes in the slope of the yield curve and changes in the spread between Treasury and LIBOR rates. The net income simulations also demonstrate projected changes in MSR and MSR hedging activity under a variety of scenarios. Additionally, management projects the fair market values of assets and liabilities under different interest rate scenarios to assess their risk exposure over longer periods of time.

The projection of the sensitivity of net interest income and net income requires numerous assumptions. Prepayment speeds, decay rates (the estimated runoff of deposit accounts that do not have a stated maturity), future deposit and loan rates and loan and deposit volume and mix projections are among the most significant assumptions. Prepayments affect the size of the loan and mortgage-backed securities portfolios, which impacts net interest income. All deposit and loan portfolio assumptions, including loan prepayment speeds and deposit decay rates, require management s judgments of anticipated customer behavior in various interest rate environments. These assumptions are derived from internal and external analyses. The rates on new investment securities are based on secondary market rates while the rates on loans are based on the rates offered by the Company to retail customers.

The slope of the yield curve, current interest rate conditions and the speed of changes in interest rates all affect sensitivity to changes in interest rates. Short-term borrowings and, to a lesser extent, interest-bearing deposits typically reprice faster than the Company s adjustable-rate assets. This lag effect is inherent in adjustable-rate loans and mortgage-backed securities indexed to the 12-month average of the annual yields on actively traded U.S. Treasury securities adjusted to a constant maturity of one year and those indexed to the 11th District FHLB monthly weighted average cost of funds index.

The sensitivity of new loan volume and mix to changes in market interest rate levels is also projected. Management generally assumes a reduction in total loan production in rising long-term interest rate scenarios accompanied by a shift towards a greater proportion of adjustable-rate production. Conversely, the Company generally assumes an increase in total loan production in falling long-term interest rate scenarios accompanied by a shift towards a greater proportion of fixed-rate loans. The gain from mortgage loans also varies under different interest rate scenarios. Normally, the gain from mortgage loans increases in falling long-term interest rate environments primarily from high fixed-rate mortgage refinancing activity. Conversely, the gain from mortgage loans may decline when long-term interest rates increase if management chooses to retain more loans in the portfolio.

In periods of rising interest rates, the net interest margin normally contracts since the repricing period of the Company s liabilities is shorter than the repricing period of its assets. The net interest margin generally expands in periods of falling interest rates as borrowing costs reprice downward faster than asset yields.

To manage interest rate sensitivity, management utilizes the interest rate risk characteristics of the balance sheet assets and liabilities to offset each other as much as possible. Balance sheet products have a variety of risk profiles and sensitivities. Some of the components of interest rate risk are countercyclical. Management may adjust the amount or mix of risk management instruments based on the countercyclical behavior of the balance sheet products.

When the countercyclical behavior inherent in portions of the Company s balance sheet does not result in an acceptable risk profile, management utilizes investment securities and interest rate contracts to mitigate this situation. The interest rate contracts used for this purpose are classified as asset/liability risk management instruments. These contracts are often used to modify the repricing period of interest-bearing funding sources with the intention of reducing the volatility of net interest income. The types of contracts used for this purpose may consist of interest rate swaps, interest rate corridors, interest rate swaptions and certain derivatives that are embedded in borrowings. Management also uses receive-fixed swaps as part of the asset/liability risk management strategy to help modify the repricing characteristics of certain long-term liabilities to match those of the assets. Typically, these are swaps of long-term fixed-rate debt to a short-term adjustable-rate, which more closely resembles asset repricing characteristics.

January 1, 2006 and January 1, 2005 Sensitivity Comparison

The table below indicates the sensitivity of net interest income and net income as a result of hypothetical interest rate movements on market risk sensitive instruments. The base case used for this

sensitivity analysis is similar to the Company s most recent earnings plan for the respective twelve-month periods as of the date the analysis was performed. The comparative results assume parallel shifts in the yield curve with interest rates rising 200 basis points in even quarterly increments over the twelve-month periods ending December 31, 2006 and December 31, 2005 and interest rates decreasing by 50 basis points in even quarterly increments over the first six months of the twelve-month periods. Periodically the Company reassesses its sensitivity analysis and, as economic conditions warrant, will update key model characteristics, assumptions and parameters used in providing quantitative information about market risk. Such updates include altering the hypothetical interest rate movements applied to market risk sensitive instruments to reflect current trends in reasonably possible near term changes in expected economic conditions. Due to continual increases in short-term interest rates since June of 2004, the Company has provided an additional sensitivity analysis that considers the hypothetical effect of interest rates rising 100 basis points and decreasing 100 basis points in even quarterly increments over the twelve-month period ending December 31, 2006.

These analyses also incorporate assumptions about balance sheet dynamics such as loan and deposit growth and pricing, changes in funding mix and asset and liability repricing and maturity characteristics. The projected interest rate sensitivities of net interest income and net income shown below may differ significantly from actual results, particularly with respect to non-parallel shifts in the yield curve or changes in the spreads between mortgage, Treasury and LIBOR rates. The analysis for January 1, 2005 excludes Providian Financial Corporation, which the Company acquired on October 1, 2005.

Comparative Net Interest Income and Net Income Sensitivity

	Gradual Change in Rates	
	-50 basis points	**+200 basis points**
Net interest income change for the one-year period beginning:		
January 1, 2006	1.46 %	(3.58)%
January 1, 2005	2.61	(2.18)
Net income change for the one-year period beginning:		
January 1, 2006	1.20	(5.32)
January 1, 2005	(0.95)	(1.37)

Net Interest Income and Net Income Sensitivity

	Gradual Change in Rates	
	-100 basis points	**+100 basis points**
Net interest income change for the one-year period beginning:		
January 1, 2006	2.62 %	(2.45)%
Net income change for the one-year period beginning:		
January 1, 2006	2.59	(3.27)

Net interest income was adversely impacted by rising short-term rates and the continued flattening of the yield curve. Short-term interest rates have increased approximately 200 basis points since December 31, 2004 while long-term rates have increased less than 50 basis points. These yield curve movements have resulted in flat Treasury and LIBOR curves at December 31, 2005.

Net interest income was projected to increase in the -50 basis point scenario as expansion of the net interest margin more than offsets the unfavorable impact of a slight decline in earning assets. Net income was projected to increase in this scenario mainly due to the increase in net interest income as other income was relatively neutral. Decreases in other income in this scenario adversely impacted the prior year s analysis.

Net interest income was projected to decrease in the +200 basis point scenario mainly due to contraction of the net interest margin. Net income was projected to decline in this scenario mainly due to the adverse impact of net interest income.

Net interest income was projected to increase in the -100 basis point scenario and decrease in the +100 basis point scenario mainly due to expansion and contraction of the net interest margin. Net income in these scenarios was primarily impacted by changes in net interest income although other income adversely affected the falling rate scenario and had a modest favorable effect in the rising rate scenario.

These sensitivity analyses are limited in that they were performed at a particular point in time. The analyses assume management does not initiate strategic actions, such as increasing or decreasing term funding or selling assets, to offset the impact of projected changes in net interest income or net income in these scenarios. The analyses are also based on the reliability of various assumptions used, including prepayment forecasts and discount rates, and do not incorporate other factors that would impact the Company s overall financial performance in such scenarios, most significantly the impact of changes in gain from mortgage loans that result from changes in interest rates. In addition, not all of the changes in fair value may impact current period earnings. For example, the portion of the MSR that does not qualify for fair value hedge accounting treatment may increase in value, but the amount of the increase that is recorded in current period earnings may be limited to the recovery of the impairment reserve within each stratum. These analyses also assume that the projected MSR risk management strategy is effectively implemented and that mortgage and interest rate swap spreads are constant in all interest rate environments. These assumptions may not be realized. For example, changes in spreads between interest rate indices could result in significant changes in projected net income sensitivity. Projected net income may increase if market rates on interest rate swaps decrease by more than the decrease in mortgage rates, while the projected net income may decline if the rates on swaps increase by more than mortgage rates. Accordingly, the preceding sensitivity estimates should not be viewed as an earnings forecast.

Operational Risk Management

Operational risk is the risk of loss resulting from human fallibility, inadequate or failed internal processes and systems, or from external events, including loss related to legal risk. Operational risk can occur in any activity, function, or unit of the Company.

Primary responsibility for managing operational risk rests with the lines of business. Each line of business is responsible for identifying its operational risks and establishing and maintaining appropriate business-specific policies, internal control procedures and monitoring tools for these risks. To help identify, assess and manage corporate-wide risks, the Company uses corporate support groups such as Legal, Compliance, Information Security, Continuity Assurance, Strategic Sourcing and Finance. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of each business.

The Operational Risk Management Policy, approved by the Audit Committee of the Board of Directors, establishes the Company s operational risk framework and defines the roles and responsibilities for the management of operational risk. The operational risk framework consists of a methodology for identifying, measuring, monitoring and controlling operational risk combined with a governance process that complements the Company s organizational structure and risk management philosophy. The Operational Risk Management Committee ensures consistent communication and oversight of significant operational risk issues across the Company and ensures sufficient resources are allocated to maintain business-specific operational risk controls, policies and practices consistent with and in support of the operational risk framework and corporate standards. The Operational Risk Management function, part of Enterprise Risk Management, is responsible for maintaining the framework and works with the lines of business and corporate support functions to ensure consistent and effective policies, practices, controls and monitoring tools for assessing and managing operational risk across the Company. The objective of the framework is to provide an integrated risk management approach that emphasizes proactive management of operational risk using measures, tools and techniques that are risk-focused and consistently applied company-wide.

The Company has a process for identifying and monitoring operational loss event data, thereby permitting root cause analysis and monitoring of trends by line of business, process, product and risk-type. This analysis is essential to sound risk management and supports the Company s process management and improvement efforts.

Maturity and Repricing Information

The Company uses interest rate contracts and available-for-sale and trading securities as tools to manage its interest rate risk profile. The following tables summarize the key contractual terms associated with these contracts and securities. Most of the interest rate swaps, swaptions, and caps at December 31, 2005 are indexed to three-month LIBOR.

The following estimated net fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies:

	December 31, 2005 Maturity Range							
	Net Fair Value	Total Notional Amount	2006	2007	2008	2009	2010	After 2010
	(dollars in millions)							
Interest Rate Risk Management Contracts:								
Asset/Liability Risk Management								
Pay-fixed swaps:	$ 11							
Contractual maturity		$ 23,458	$ 11,933	$ 4,506			$ 5,117	$ 1,902
Weighted average pay rate		4.30 %	3.69 %	4.95 %			4.92 %	4.97 %
Weighted average receive rate		4.36 %	4.33 %	4.37 %			4.43 %	4.35 %
Receive-fixed swaps:	(364)							
Contractual maturity		$ 29,303	$ 1,000	$ 12,773	$ 5,173	$ 1,232	$ 1,185	$ 7,940
Weighted average pay rate		4.32 %	4.34 %	4.20 %	4.07 %	4.77 %	4.25 %	4.60 %
Weighted average receive rate		4.34 %	6.81 %	3.67 %	4.12 %	4.25 %	5.67 %	5.07 %
Basis swaps:	2							
Contractual maturity		$ 5,000		$ 3,500	$ 500	$ 1,000		
Weighted average pay rate		3.97 %		3.98 %	3.94 %	3.95 %		
Weighted average receive rate		4.29 %		4.29 %	4.29 %	4.29 %		
Interest rate caps:	11							
Contractual maturity		$ 13,070	$ 13,070					