



Home Loans Discussion  
Board of Directors Meeting

April 18, 2006

**Confidential**

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*President, Home Loans*

Permanent Subcommittee on Investigations  
**EXHIBIT #3**

JPM\_WM00690890

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**Financial Model Output pages** – Model Output tab - second to last tab

**Key Performance Indicators and Model Assumptions** – Assumptions tab - last tab

## Home Loans Business Model



*The prime mortgage banking business model was built to take advantage of large refinance cycles, and is not well positioned in more challenging environments.*

- **"Mono-line" structure focused on low-margin, prime market segment**
  - In 2005, 85% of production was Prime
  - <4% of production volume was sourced from Financial Centers
- **Goals were largely driven by overall market share growth**
  - Attracted and retained a high producing and high cost sales structure
  - Pricing strategy targeted within top 3
- **Profitability is disproportionately influenced by market factors**
  - Fee-based (Gain on Sale) model dependent on market cycles for high returns, and is not consistent with low efficiency ratio
  - Volatile MSR contributed >50% of net income over last 2 years

*The effects of the model have created unacceptable levels of volatility and risk for Washington Mutual.*

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### **In 2005, 85% of production was Prime**

- 2005 volume by product (data behind slide)

### **<4% of production volume was sourced from Financial Centers**

- FC first mortgage referrals (PFRs) was <4% of total origination volume \$248B
- The amount of Home Equity product funded through the FCs in 2005 was \$4.4B, which is <4% of total LC Retail volume of \$103B
- In 2008, the LCs paired with the Retail Bank are estimated to originate \$10.4B in the FCs, and another \$5.7B which is generated by the PFRs
  - 28% of the total Retail volume in 2008 of \$57B
  - 7% of total Production of \$232B

### **Goals were largely driven by overall market share growth**

- Market share slides (data behind slide)

## Home Loans Strategic Positioning



*Home Loans is accelerating significant business model changes to achieve consistent, long-term financial objectives.*

- Shift from low-margin business to high-margin products
- Reallocate risk from market-based to credit
- Continue to attack the cost structure

### Financial Objectives

	Q1 2006	Target
Net Income Growth (from Q1 2005)	(90%)	10-12%
Return on Tangible Equity	5%	~18%
Efficiency Ratio	91%	<50%
Net Cost to Hedge MSR (annualized)	\$502M	<\$100M

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### Definition of High Margin Products

- Home Equity, Subprime, Alt A, Option ARM

### Historical net income:

- 2005 Actual: \$1,235M
- 2006 March Forecast: \$323M

### ROE

- 2005 Actual: 26%
- 2006 March Forecast: 7%

### Efficiency Ratio

- 2005 Actual: 56%
- 2006 March Forecast: 82%

### Cost to Hedge

- 2005 Actual: \$621M (pre-tax)
- 2006 March Forecast (annualized): (\$502M)

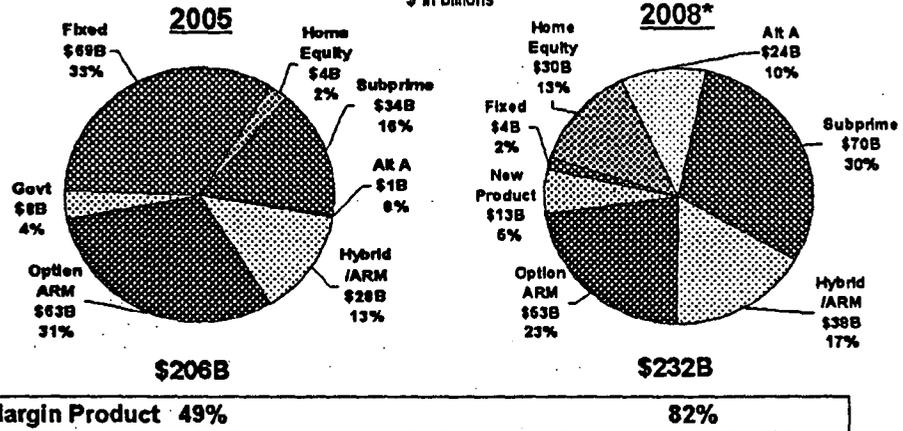
# Shift to Higher Margin Products



**2005 WaMu Gain on Sale Margin by Product**  
in bps

Government	13
Fixed	19
Hybrid/ARM	25
Alt A	40
Option ARM	109
Home Equity	113
Subprime	150

**WaMu Volume by Product**  
\$ in billions



\* Assumes a \$2.3 trillion origination market

### Strategic Response

- Refine distribution to target specific higher-margin products – Subprime, Alt A, and Home Equity
- De-emphasize low-margin products by realigning Correspondent channel
- Leverage balance sheet advantage by introducing a series of innovative products

### Execution

- De-emphasize Fixed Rate and cease Govt
- Deploy Alt A to Retail and Wholesale
- Deploy Home Equity in Retail and Wholesale
- Create a Home Equity Conduit  Q2 06
- Develop a new product  Q4 06 – Q1 07

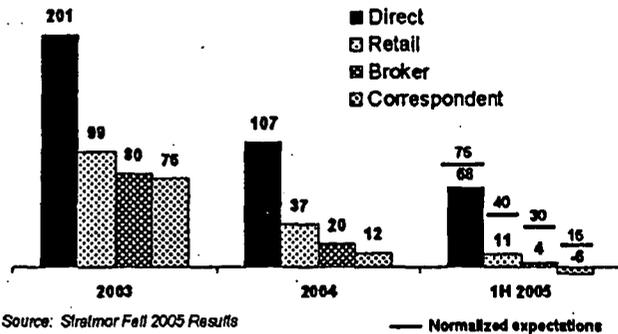
**Grow market share in targeted product segments**

# Shift to Higher Margin Channels



## Industry Margin Compression

In bps



Source: Stralmar Fall 2005 Results

## 2005 Correspondent Product Mix

\$ in billions

### Sources of Fixed & Government Volume

Retail	\$12	18%
Wholesale	\$11	16%
Consumer Direct	\$8	12%
Correspondent	\$35	54%

### Correspondent Volume by Product

Fixed	\$28	74%
Government	\$7	18%
ARM	\$1	4%
Option ARM	\$2	5%

Correspondent channel produces disproportionately more Fixed and Government product

## Correspondent Realignment

### Correspondent

- Disproportionate generator of expensive MSR product
- Traditionally low-margin channel
- Acquires customers that are out of Footprint
- Limited cross-sell opportunities, low retention

### Conduit

- Focus exclusively on high-margin products
- Highly variable and more efficient cost structure
- Leverage Capital Markets distribution and underwriting
- Flexibility to manage volumes

## Execution

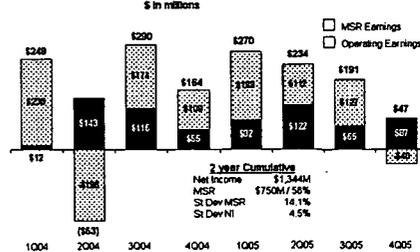
- Focus Conduit on high-margin products
  - Subprime
  - Alt A
  - Home Equity  Q2 06
- Reposition Correspondent channel  Q3 06
- Leverage Consumer Direct to include Subprime  Q3 06

**Realign Correspondent to Conduit**

## Reduce Earnings Volatility



### Prime Home Loans Net Income



### MSR as a % of Shareholders' Equity (at year end)

Company	2005 (%)
Countrywide	98%
Wells Fargo	31%
Washington Mutual	29%
JP Morgan Chase	6%
Citigroup	4%
Bank of America	3%
Golden West	<1%

### MSR Risk Profile (As of February 28, 2006)

Current Risk Profile	Unpaid Principal Balance (\$B)	Market Value (RV) (\$B)	Annual Hedge Cost (\$M)	% Cost to MV
Option ARM/ARM	\$123.5	\$1.5	(\$21)	1.4%
Fixed	\$401.8	\$8.0	(\$14)	5.3%
Government	\$55.0	\$1.0	(\$8)	4.7%
Subprime	\$28.3	\$0.2	(1)	0.5%
<b>Total</b>	<b>\$608.6</b>	<b>\$8.7</b>	<b>(\$394)</b>	<b>4.4%</b>
2006 pro-forma	\$410.6	\$4.4	(\$122)	2.8%

- 94% of hedge costs attributable to Fixed and Govt
- Portfolio loans = \$0 MSR

### Execution

- Eliminate excess service fee on Fixed rate
- Price Fixed rate at higher margin targets
- Cease Govt lending in Retail and Wholesale
- Negotiate 1/8 basis points service fee
- Build whole loan portfolio  Q3 06
- Evaluate sale of Govt and Fixed rate servicing  Q3 06 - Q4 07

**Reduce MSR exposure, limit volatility and realign distribution**

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### Q1 2005 and Q1 2006 prime and all-in net income split

- Q1 2005 - \$176M Operating / \$151 MSR = \$324M
- Q1 2006 - \$131M Operating / (\$92) MSR = \$38M

### MSR Comparison - % of Market Cap (data behind slide)

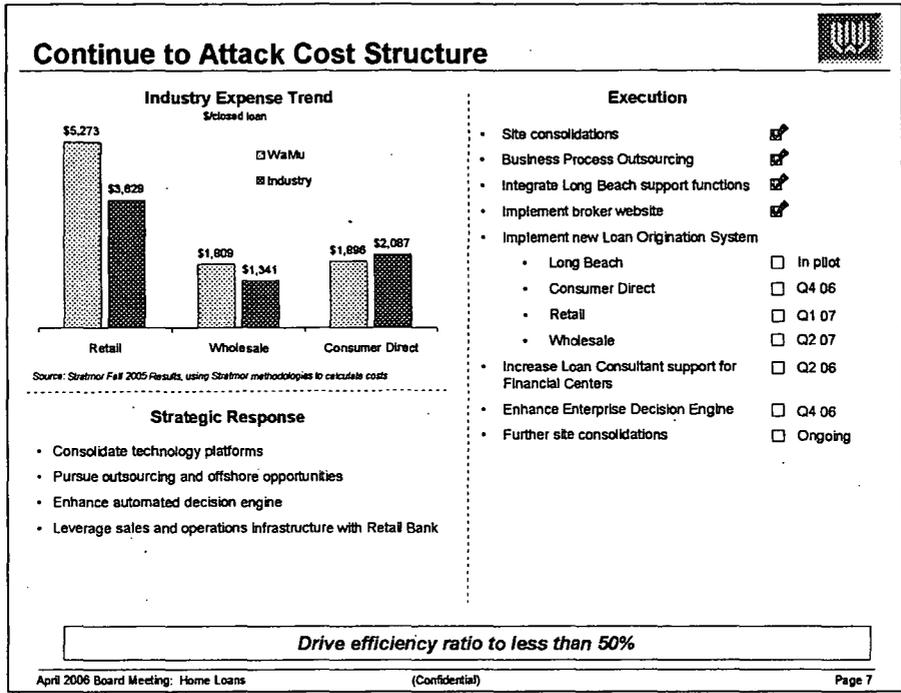
### Cease Govt Lending in Retail and Wholesale

- Retail is scheduled for 5/2/06
- Wholesale was on 3/15/06

### 1/8 Basis Point will be implemented in July 2006

### Post Sales Dates

- Q3 06 - \$47.5B (GNMA)
- Q1 07 - \$137.5B (Fixed)



**FTE Outsourcing**

- 350 FTE offshored in 2004
- Targeting 1,100 by end of 2006
- TSG support is an additional 60

**Site Consolidations** (see Quad 1-pagers by business unit in Appendix)

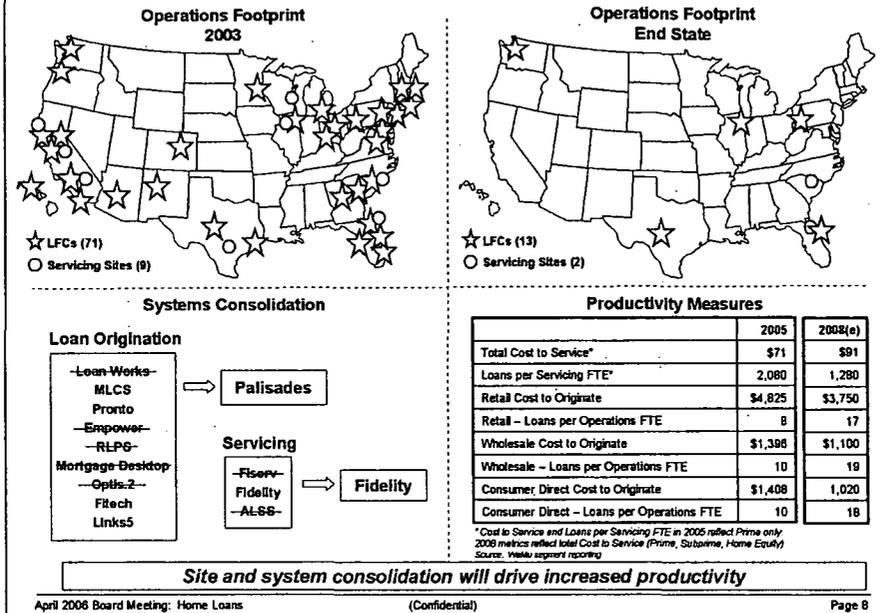
**Status of Long Beach pilot**

Active Loans: 107  
 Funded Loans: 2  
 Loans submitted (max in single day during pilot): 23 on 4/6/2006  
 Peak users: 41 LBM LOS  
 First loan e-submitted via BFO: 4/11/2006  
 First loan funded and confirmed GL file received: 4/11/2006  
 Pilot is at Denver LFC. As of 4/10/2006, entire LFC is "up" on LBM LOS.  
 Last code release into production (a pricing update, 5.6.6.3) done 4/11/2006.

**Loans Consultants** – 2,200 financial centers covered by year-end 2008

\*Note 1: The Stratmor study excludes Subprime  
 \*Note 2: A list of Stratmor Study company participants is behind slide

## Continue to Attack Cost Structure



### Date of Palisades full implementation

- The first phase of what is called the STeP program has been defined – it's the Palisades implementation for Consumer Direct slated for Q4 2006
- Retail – 1Q07
- Wholesale – 2Q07

### 2008 Servicing breakout (Prime, Subprime, Home Equity)

Loans per FTE Summary:	2006	2007	2008
Prime servicing	1,689	1,770	1,813
Sub Prime servicing	489	499	514
Home Equity servicing	1,721	1,756	1,809
<b>Total</b>	<b>1,450</b>	<b>1,338</b>	<b>1,287</b>

Cost to Service (per unit)	2006	2007	2008
Prime servicing	76	69	69
Sub Prime servicing	207	197	187
Home Equity servicing	108	96	94
<b>Total</b>	<b>85</b>	<b>87</b>	<b>91</b>

### Productivity Measures – 2005 and March 2006 Forecast for Prime only (behind slide)

## Risks



- Margin compression on current high-margin products
- Transaction costs on Servicing sales
- Organizational capability to manage credit risk
- Successful technology implementation
  - Enterprise Decision Engine at point of sale
  - Loan Origination System in all channels
- Organization's ability to execute on significantly accelerated pace of change

## Summary – Next Steps



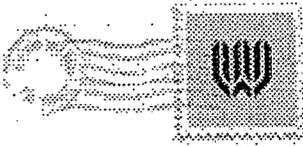
- **Shift from low-margin business to high-margin products**
  - De-emphasize Fixed rate and cease Government
  - Realign Correspondent to Conduit
  - Invest in Direct-to-Consumer platform
- **Reallocate risk from market-based to credit-based assets to reduce earnings volatility**
  - Significantly reduce exposure to MSR
  - Market Government and Fixed rate servicing
  - Build Home Loans portfolio
- **Continue to attack the cost structure**
  - Consolidate additional sites
  - Implement new Loan Origination System and enhance Enterprise Decision Engine
  - Leverage distribution in Financial Centers

# Appendix – Project Plan



	2006			2007			2008					
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
RETAIL	Q3 '06			Develop new recruiting strategy and training programs								
	Q4 2006			First consolidation phase for HLCs and LFCs								
	1/07			Profit-driven comp plans to the field								
	4/07			New integrated POS and LOS								
LONG BEACH	Q4 2006			BFO Rollout and LOS Deployment						2008 LFC Consolidation		
	6/06			P&Ls by business line, WLC and Broker								
WHOLESALE	Q3 2006			Bundled HELOCs on wamubroker.com and Premier Broker Program								
	Q4 2006			Standalones Introduced								
	Q4 '06			Q3 2007			Q1 '08			3 in Q1 2008		
CONSUMER DIRECT	Q4 2006			Q3 2007			Q1 2008			New product rollout		
	Q4 2006			Subprime and Alt A processing capabilities								
	Q4 2006			New Prime LOS								
	Q3 2007			Robust Internet Site								
	Q1 2007			Siebel 7 Upgrade								
CONDUIT/CAPITAL MARKETS	Q2 2006			Q2 2007			Acquisition marketing execution and Upgraded telephony technology					
	Q2 2006			Q4 2006 - 2007			MSR Sales					
	Q4 2006			Develop HE Conduit Team and Corporate Credit Approvals • Transfer Pricing and Capital								
	Q4 2006			Develop Portfolio and MSR Sales Capabilities • Recognize Market Risk Management functions								
SERVICING	Q1 '07			Implement OAS								
	Q2 2006			Sale of CRC								
	Q3 2006			Fusion Completion • Sale of GNMA Servicing • HE line/loan servicing capability								
	Q1 2007			Migration of Chatsworth subprime default servicing to Jacksonville								
	Q1 2007			Sale of Fixed Rate loans								
	Q2 2007			Q1 2008			Custodial Strategy					
	Q2 2007			Q1 2008			Migration of Milwaukee functions to Jacksonville and Florence					

Refer to quad 1-pagers on each business unit (behind slide)



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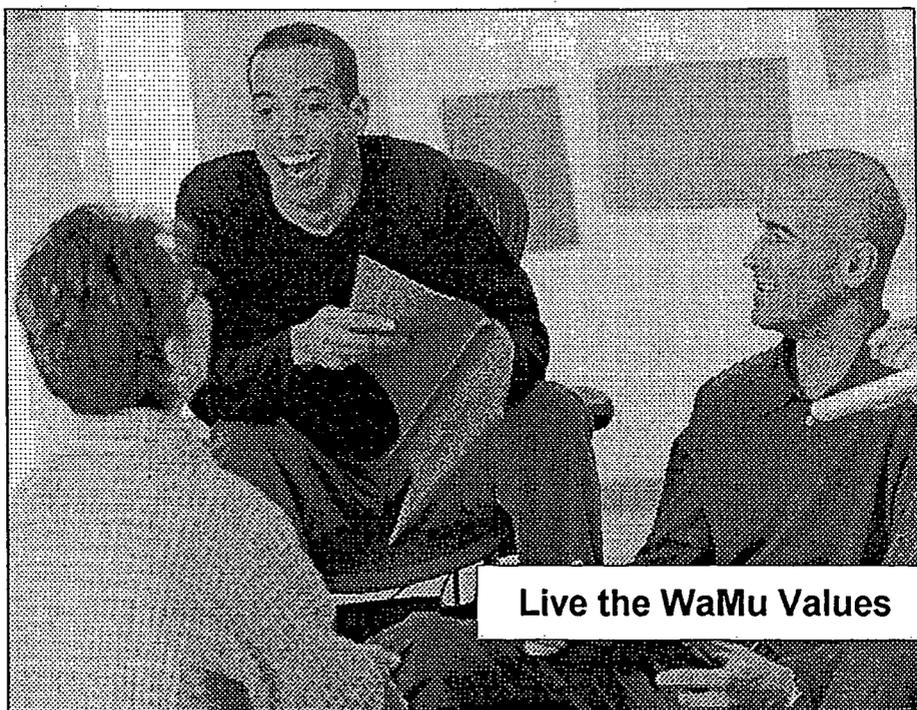
**Be Bold!**

David Schneider, President

**BOLD**

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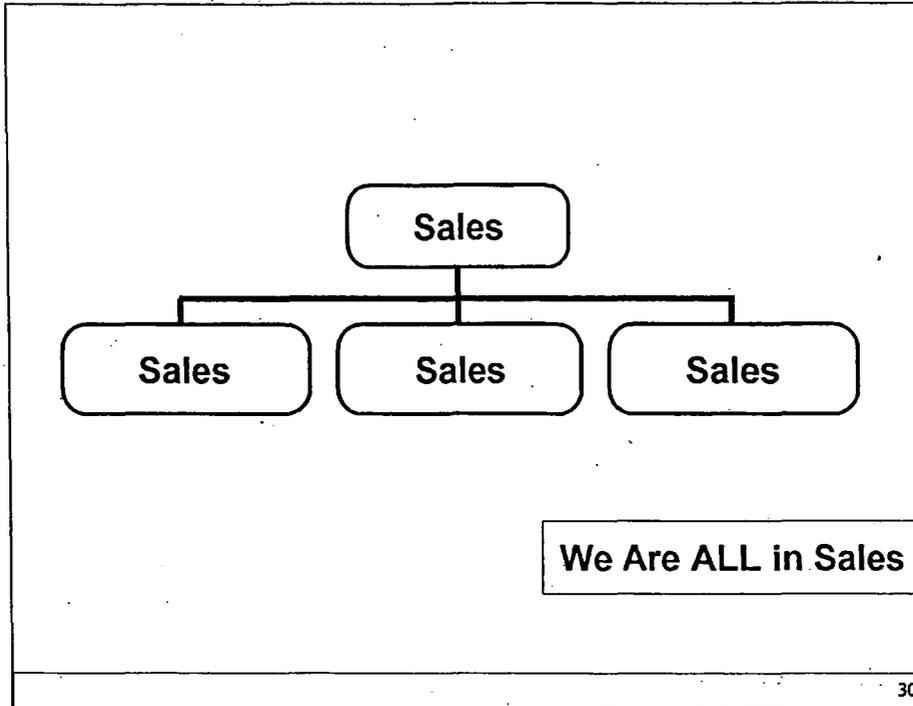
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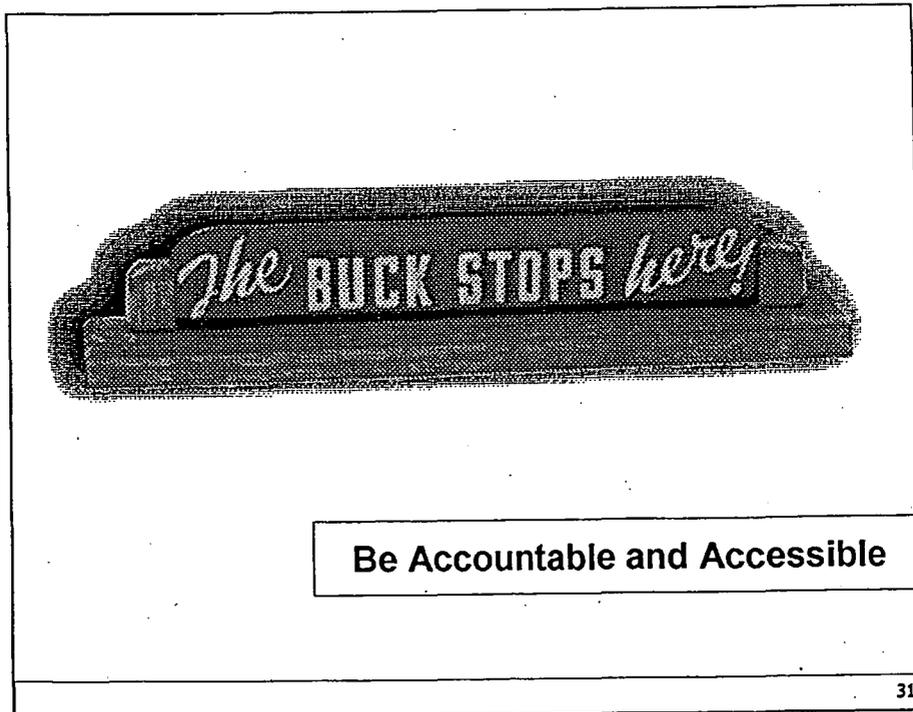
**Live the WaMu Values**

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**EXHIBIT #4**

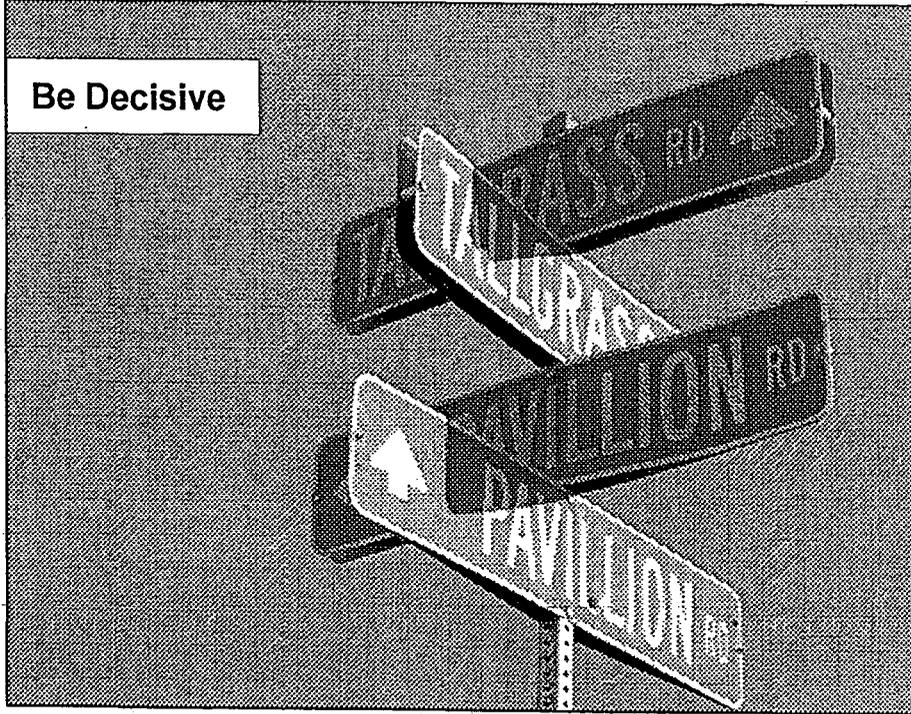


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**Be Decisive**

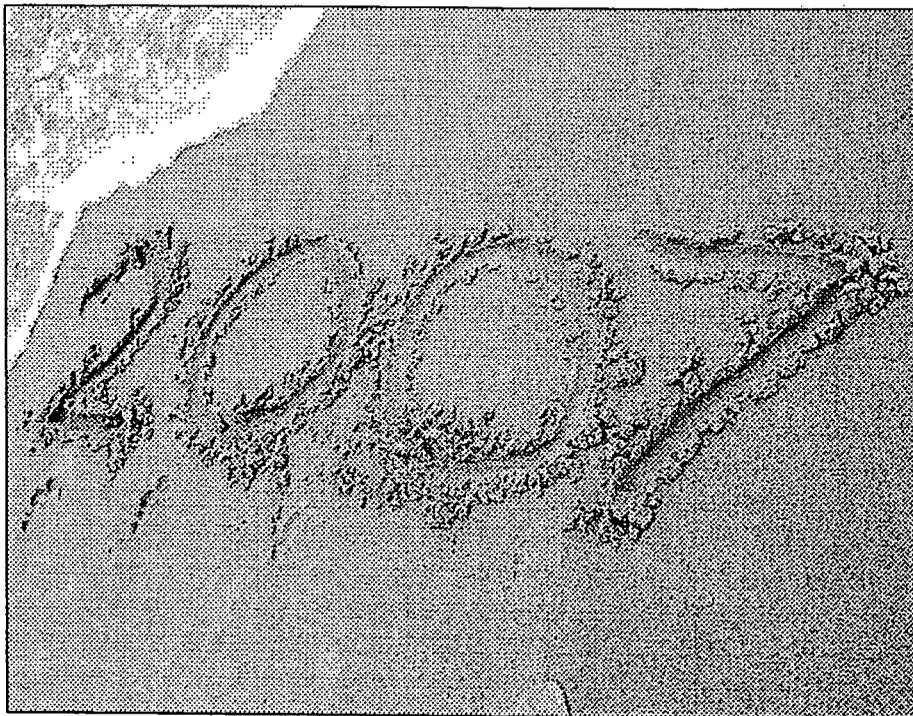


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**Have Fun**



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## 2007 Focus Areas

### Growth

- Simple Loan Manager
- WaMu Mortgage Plus
- Expand Subprime
- Grow Prime Sales Force
- Expand Investor Sales Capability

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# Q & A



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