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.

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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 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